Section 4: Business

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Ruling Below: Busk v. Integrity Staffing Solutions, Inc., 713 F.3d 525 (9th Cir. 2013), cert granted, 134 S.Ct. 1490 (U.S. 2014).

Former employees brought putative class action against former employer, alleging violations of the Fair Labor Standards Act (FLSA) and Nevada labor laws. The United States District Court for the District of Nevada, Roger L. Hunt, Senior District Judge granted employer's motion to dismiss. Employees appealed.

Question Presented: Whether time spent in security screenings is compensable under the Fair Labor Standards Act, as amended by the Portal-to-Portal Act.
violations of the Fair Labor Standards Act (FLSA) and Nevada labor laws.

Busk and Castro alleged Integrity violated federal and state labor laws by requiring them to pass through a security clearance at the end of each shift, for which they were not compensated. Employees waited up to 25 minutes to be searched; removed their wallets, keys, and belts; and passed through metal detectors. The plaintiffs alleged the clearances were “necessary to the employer's task of minimizing ‘shrinkage’ or loss of product from warehouse theft.”

The plaintiffs also sought compensation under FLSA and Nevada law for their entire 30–minute unpaid lunch periods because they spent up to 10 minutes of the meal period “walking to and from the cafeteria and/or undergoing security clearances.” They said it took them about five minutes after punching out “to walk to the facility cafeteria and/or pass through security clearances” and “approximately five minutes to walk from the cafeteria to the time keeping system to clock back in.” Additionally, managers would frequently “remind” workers to “finish their meal period quickly so that they would clock back in on time.”

The district court granted Integrity's motion to dismiss the amended complaint for failure to state a claim under FLSA because the plaintiffs did not allege that they performed “any duty related to their job as warehouse workers” during their lunch breaks.

The district court also held that the state law claims “must be dismissed” due to “conflicting” class certification mechanisms, namely that while plaintiffs must opt into a collective action under FLSA, plaintiffs must opt out of a class action under Federal Rule of Civil Procedure 23. Alternatively, the court dismissed the state claims on the merits. It held that since the claims were based entirely on the security clearance and lunch allegations, the “Plaintiffs have failed to allege fact scenarios that would support a valid claim” under Nevada law.

II

We review de novo the district court's conclusion that a FLSA collective action and state law class action are inherently incompatible as a matter of law. We agree with all other circuits to consider the issue that such actions can peacefully coexist. Therefore, the district court erred in dismissing the state law claims based on a perceived conflict.

Under FLSA, a potential plaintiff does not benefit from (and is not bound by) a judgment unless he or she “affirmatively ‘opts in’ ” to the lawsuit. This rule is in contrast to a typical Rule 23 class action, where a potential plaintiff must opt out to be excluded from the class. Although some district courts have held that a FLSA collective action cannot be brought in the same lawsuit as a state-law class action.
based on the same underlying allegations, all
circuit courts to consider the issue have held
that the different opting mechanisms do not
require dismissal of the state claims.

Our sister circuits have correctly reasoned
that FLSA's plain text does not suggest that
a district court must dismiss a state law
claim that would be certified using an opt-
out procedure. Its opt-in requirement
extends only to “any such action”—that is, a
FLSA claim. FLSA also expressly permits
more protective state labor laws. This
savings clause provides further evidence that
a federal lawsuit combining state and federal
wage and hour claims is consistent with
FLSA.

Nor does the legislative history of Section
216(b) support the view of some district
courts that allowing both actions to proceed
simultaneously “would essentially nullify
Congress's intent in crafting Section 216(b)
and eviscerate the purpose of Section
216(b)'s opt-in requirement.” We agree with
the Third Circuit that the “full legislative
record casts doubt” on the contention that
Section 216(b) was intended to eliminate
opt-out class actions. When Congress
created Section 216(b)'s opt-in requirement
as part of the Portal–to–Portal Act of 1947,
it was responding to concerns about third
drives filing “representative” FLSA actions
on behalf of disinterested employees.
Accordingly, it amended FLSA “for the
purpose of limiting private FLSA plaintiffs
to employees who asserted claims in their
own right and freeing employers of the
burden of representative actions.”

This purpose does not evince an intent to
eliminate opt-out class actions for state wage
and hour claims brought in federal court.
Even if it did, Congress has expressed a
contrary intent in the Class Action Fairness
Act of 2005, which confers federal
jurisdiction over class actions where certain
diversity and amount-in-controversy
requirements are met. Because the Class
Action Fairness Act provides that federal
courts should exercise jurisdiction over
certain class actions (including those
alleging violations of state wage and hour
laws), and these class actions are certified
pursuant to Rule 23’s opt-out procedure, we
cannot conclude that Congress intended
such claims be dismissed simply because
they were brought in conjunction with FLSA
claims.

Integrity argues that allowing both classes to
proceed simultaneously would cause
“unnecessary confusion” for potential class
members who would receive notices “stating
both that they must opt in to have their
compensation issues adjudicated and that
they must opt out to avoid having their
compensation issues adjudicated.” While we
do not minimize this practical concern, we
agree with the Seventh Circuit that district
courts should be able to “work[ ] out an
adequate notice in this type of case.”
Furthermore, “if these actions were to
proceed separately—the FLSA in federal
court and the state-law class action in state
court—an entirely different and potentially
worse problem of confusion would arise,
with uncoordinated notices from separate
courts peppering the employees.”

In sum, we agree with the other circuits to
consider the issue that the fact that Rule 23
class actions use an opt-out mechanism
while FLSA collective actions use an opt-in mechanism does not create a conflict warranting dismissal of the state law claims.

III

Turning to the merits, we review de novo a district court's dismissal of a complaint for failure to state a claim under Rule 12(b)(6). Accepting the plaintiffs' allegations as true and construing them in the light most favorable to plaintiffs, we may affirm a dismissal only if the complaint fails to state a claim for relief that is plausible on its face. Applying this standard, we hold that the district court erred in holding that the plaintiffs failed to state a claim under FLSA for passing through security clearances at the end of the day. But, under the facts alleged, we affirm its dismissal of the claim for shortened lunch periods.

A

FLSA, as amended by the Portal–to–Portal Act of 1947, generally precludes compensation for activities that are “preliminary” or “postliminary” to the “principal activity or activities” that the employee “is employed to perform.” But preliminary and postliminary activities are still compensable under the Portal–to–Portal Act if they are “integral and indispensable” to an employee's principal activities. To be “integral and indispensable,” an activity must be (1) “necessary to the principal work performed” and (2) “done for the benefit of the employer.”

In *Alvarez*, we held that putting on and taking off protective gear was necessary to the principal work of employees at a meat packing plant because the gear was required by the employer's rules, by federal regulators, and by the “‘nature of the work.’” Moreover, the donning and doffing benefited the employer by preventing “workplace injury and contamination.” But in *Bamonte v. City of Mesa*, we held that donning and doffing police uniforms was not necessary to police officers' principal work because they could change at home and chose to do so at work for their own benefit.

Here, Busk and Castro have alleged that Integrity requires the security screenings, which must be conducted at work. They also allege that the screenings are intended to prevent employee theft—a plausible allegation since the employees apparently pass through the clearances only on their way out of work, not when they enter. As alleged, the security clearances are necessary to employees' primary work as warehouse employees and done for Integrity's benefit. Assuming, as we must, that these allegations are true, the plaintiffs have stated a plausible claim for relief.

In holding otherwise, the district court relied upon out-of-circuit cases holding that time spent clearing security was not compensable under the Portal–to–Portal Act. But these cases are distinguishable because, in these cases, everyone who entered the workplace had to pass through a security clearance. In *Gorman v. Consolidated Edison Corp.*, the Second Circuit held that security procedures at a nuclear power plant were part of noncompensable travel time under 29 U.S.C. § 254(a)(1) in part because the “security measures at entry are required (to one
degree or another) for everyone entering the plant,” including visitors. In *Bonilla v. Baker Concrete Construction Inc.*, the Eleventh Circuit held that construction workers employed by a subcontractor to work on an airport construction project were not entitled to compensation for passing through a security clearance. Because the Federal Aviation Administration mandated the security process, the court held that the screening did not benefit the employer.

*Gorman* and *Bonilla* do not concern a security screening put in place because of the nature of the employee's work. But here Integrity allegedly requires the screening to prevent employee theft, a concern that stems from the nature of the employees' work (specifically, their access to merchandise). Therefore, the district court erred in assuming *Gorman* and *Bonilla* created a blanket rule that security clearances are noncompensable instead of assessing the plaintiffs' claims under the “integral and indispensable” test.

Because we hold that the plaintiffs have stated a valid claim for relief under FLSA for the time spent passing through security clearances, we also reverse the district court's dismissal of the parallel state law claim.

**B**

The district court also held that the plaintiffs failed to state a claim under FLSA for their shortened lunch periods. Under the facts as alleged, we agree.

FLSA does not require compensation for an employee's lunch period, but an “employee cannot be docked for lunch breaks during which he is required to continue with any duties related to his work.” An “employee is not relieved if he is required to perform any duties, whether active or inactive, while eating.” For example, “an office employee who is required to eat at his desk or a factory worker who is required to be at his machine is working while eating.”

Here, Busk and Castro alleged they were not “completely relieved from duty” because by placing the time clocks far from the lunchroom, Integrity forced upon them the “duty to walk to the lunchroom in order to eat lunch.” But the district court correctly held that walking to the lunchroom is not a work duty. Walking to the lunchroom is not necessary to the plaintiffs' principal work as warehouse employees. Moreover, though the Portal–to–Portal Act does not clearly preclude compensation for walking to the lunchroom, as it only expressly applies to walking before the workday starts and after it ends, it would be incongruous to preclude compensation for walking into work on the employer's premises, but require it for walking to the lunchroom.

Busk and Castro also argue they are entitled to compensation for their entire 30–minute lunch periods because supervisors would frequently “remind” workers to “finish their meal period quickly so that they would clock back in on time.” They rely upon cases noting that “very frequent interruptions” might make meal periods compensable. But these cases concern whether employees are entitled to compensation for lunch periods when they remain “on call.” They use the term
“interruptions” to refer to instances where the employee has to resume a work duty—for instance, when emergency medical service employees fielded emergency calls, or maintenance workers responded to maintenance problems. That supervisors may have “interrupted” Busk and Castro in another sense of the word does not make their lunch periods compensable absent any claim that they performed a work duty.

Finally, the first amended complaint alleges that employees had to pass through a security clearance on their way to the lunchroom. Assuming that the time passing through the security clearance on the way to lunch constitutes compensable work, the time alleged in this case is de minimis. As alleged in the first amended complaint, the walk to and from the cafeteria takes “approximately five minutes” each way, though employees pass through security only on their way to the cafeteria, not on the return trip. The relatively minimal time expended on the clearance in this context differs from the 25–minute delay alleged for employees passing through security at day's end. Therefore, the district court correctly dismissed this claim under Rule 12(b)(6).

The plaintiffs also argue that even if the district court correctly dismissed their FLSA claim relating to the shortened lunch periods, it should not have dismissed their state law claim because Nevada law would require compensation even when federal law does not. Nevada law requires that an employer provide a half-hour meal break if it employs a worker for a continuous eight-hour period. The law provides, “No period of less than 30 minutes interrupts a continuous period of work for the purposes of this subsection.” But there is no private right of action to enforce this section. The Nevada Legislature has entrusted the enforcement of this statute to the state Labor Commissioner by expressly providing that the “Labor Commissioner or the representative of the Labor Commissioner shall cause the provisions of NRS 608.005 to 608.195, inclusive, to be enforced.”

Nevada Revised Statute § 608.140 does provide a private right of action to recoup unpaid wages. Thus, the district court correctly focused on whether Busk and Castro alleged they were required to “work” during their lunch periods. However, the plaintiffs raised for the first time on appeal their argument that Nevada defines “work” differently than federal law, such that their lunch periods might be compensable under state law even if they were not compensable under federal law. Because the district court has not considered this argument, we remand for it to do so in the first instance.

Affirmed in part; reversed in part; remanded. Each party shall bear its own costs on appeal.
“Amazon Warehouse Worker Pay Suit Heads to Supreme Court”

Fortune
Claire Zillman
March 3, 2014

Security lines. They are the worst. And many workers have to pass through them every day. The U.S. Supreme Court decided on Monday to tackle the question of whether the time spent waiting in those lines is deserving of hourly pay.

The Supreme Court said that it would hear a class action lawsuit filed in 2010 by former employees of Amazon contractor Integrity Security Systems who claim that, under the Fair Labor Standards Act (FLSA), they deserve back pay for the time they spent in security checks at the beginning and end of the day, which the warehouse mandated to prevent employee theft.

The workers were “required to wait at least 10 to 15 minutes each day, and often more than a half hour, at the beginning and end of each shift without compensation whatsoever in order to undergo a search for contraband and/or pilferage of inventory,” the complaint says.

Integrity Security contends that the security screenings are similar to other tasks — such as waiting to punch the clock or walking to and from the workplace — that are non-compensable under the FLSA. Amazon said on Monday that it doesn’t comment on pending litigation.

The Supreme Court never explains why it accepts or rejects a case, but the widespread use of security checks in workplaces likely carried a lot of weight.

In petitioning the Supreme Court to take the case, Integrity’s lawyer, Paul Clement, argued that “in the post-9/11 world, security screenings have become ubiquitous in the American workplace and are routinely required for employees working in skyscrapers, corporate campuses, federal, state, and local government officers, courthouses, sports arenas, museums, airports, power plants, theme parks, and countless other places.” Allowing the Nevada workers’ suit to go forward, Clement argued, “opens employers up to billions of dollars in retroactive damages.”

Indeed, after the U.S. Court of Appeals for the 9th Circuit let the Nevada workers’ case continue, other employees filed similar nationwide class actions against Amazon distribution centers in Kentucky, Tennessee, and Washington state. Workers at a regional distribution center sued CVS Pharmacy in September 2012 over its security checks, and tens of thousands of workers sued Apple in July 2013 because it requires its hourly retail employees to go through bag searches and clearance checks.

Wage and hour lawsuits in general — in which workers accuse their employers of unfair pay practices — is one of the few areas of workplace litigation that’s on the
rise. There were 7,882 lawsuits filed under the FLSA last year, up about 3% from 2012, according to the Annual Workplace Class Action Litigation Report from law firm Seyfarth Shaw. Many of the lawsuits hinge on what sort of activity constitutes the compensable workday, says Gerald Maatman, a labor and employment lawyer at Seyfarth, who is representing a third-party contractor in one of the Amazon lawsuits.

The Supreme Court’s decision in the Integrity case will at least give a definitive answer to the question of whether security checks should be included in the payable workday. Other courts have tackled this issue before: the Eleventh Circuit evaluated whether airport employees deserved pay for their time in the security line, and the Second Circuit decided the issue as it related to workers at a nuclear power plant. In both cases, the courts sided with the employers. But the Integrity case is different and a fairer test of the issue because it’s the employer itself — Integrity Security — that mandated the security checks, not an outside authority like the Transportation Security Administration.

That means the outcome of the Integrity case will apply to a “greater variety of companies,” says Mark Batten, a labor and employment lawyer at Proskauer Rose. “It will have a lot of impact on a lot of businesses.”
Over the years, the U.S. Supreme Court has had multiple occasions to address whether — and under what circumstances — employers must compensate employees for their time going from point A to point B and back. Most often, this question has arisen in “donning and doffing” cases, in which point A is the place where uniforms or protective gear are put on and taken off and point B is the location where employees perform their principal duties.

The question revolves around the distinction between activities that are “integral and indispensable” to an employee’s principal activities, which are compensable under the Fair Labor Standards Act, and activities that are merely “preliminary” and “postliminary,” which are excluded from compensable time by the Portal-to-Portal Act.

On March 3, 2014, the Supreme Court agreed to hear the case of Integrity Staffing Solutions Inc. v. Busk, which presents a new twist to this issue, that is somewhat a creature of the modern age. Integrity Staffing is not a donning and doffing case. Instead, it relates to the time employees spend going from point B (i.e., where they fill customer orders for retail goods) back to point A (i.e., where the employer requires them to pass a security screening before leaving the facility).

Framework of Existing Case Law

The FLSA, as originally passed, was interpreted by the Supreme Court in Anderson v. Mt. Clemens Pottery Co. (1946) to require compensation for all time during which an employee was required to be on the employer’s premises. Congress quickly responded to a sharp increase in litigation that arose after that decision by passing the Portal-to-Portal Act in 1947, which excludes two categories of activity from compensable time: (1) traveling to and from the place where employees perform their principal activities, and (2) “activities that are preliminary to or postliminary to” “the principal activity or activities which” the individual is employed to perform.” This left for the courts to define in any given case what employee activities are “principal.”

The Supreme Court subsequently held that activities which are “integral and indispensable” to an employee’s “principal” activities are themselves principal activities and therefore compensable. In 1956, the high court addressed the issue in two cases.

In Steiner v. Mitchell, it held that changing clothes and showering were compensable activities for employees who worked in an environment where caustic and poisonous chemicals were used in their work. In Mitchell v. King Packing Co., the Supreme Court held that knife sharpening is “an integral part of and indispensable to” the butchering activities for which the employees were principally employed.
Then, in 2005, the Supreme Court held in *IBP v. Alvarez*, that employee time spent walking at the end of the day from the location where they performed their meat processing activities back to the area where they removed their protective gear — an activity the employer conceded was integral and indispensable to the meat processing duties — was compensable.

The Supreme Court explained that “during a continuous workday, any walking time that occurs after the beginning of the employee’s first principal activity and before the end of the employee’s last principal activity” is compensable. Applying these rules, lower courts have held that time spent waiting to punch in and out on a time clock, walking from an employer’s parking facility to the workplace and even changing clothes or showering, where those activities could be performed off-site, is not compensable under the FLSA.

The Challenge of Security Screenings in the Workplace

Integrity Staffing supplies warehouse workers on a contract basis to various clients; the plaintiffs worked for Integrity filling customer orders for retail goods at warehouses owned by Amazon.com in Nevada. At the ends of their shifts, the plaintiffs and their fellow order-fillers were required to pass through a security screening station designed to reduce employee theft. The screening process itself appears to have been relatively simple — employees were required to empty their pockets and walk through a metal detector. According to the plaintiffs, however, the security stations were badly understaffed, resulting in wait times of up to 25 minutes as hundreds of employees’ shifts ended simultaneously. Seeking compensation for the time they spent in this process, the plaintiffs filed a class action complaint on behalf of themselves and those similarly situated.

The U.S. district court in Nevada granted Integrity’s Rule 12 motion to dismiss; the Ninth Circuit reversed. The Ninth Circuit applied a two-pronged test to determine whether the activity at issue was “integral and indispensable,” considering whether it is: (1) “necessary to the principal work performed” and (2) “done for the benefit of the employer.” Because the security screening process was allegedly required by Integrity for the purpose of preventing theft by employees with access to retail merchandise, the circuit court explained, the plaintiffs’ allegations were sufficient at the motion-to-dismiss stage to conclude that the screening was integral and indispensable to their principal activity of filling customer orders. Put slightly differently, the Ninth Circuit reasoned that if the screening was not aimed at all employees, then it must be related to the work performed by those employees to which it did apply. Relying on the allegation that all employees were not required to participate in the security screening, the Ninth Circuit distinguished the case before it from a Second Circuit case, *Gorman v. Consolidated Edison Corp.*, and an Eleventh Circuit case, *Bonilla v. Baker Concrete Construction Co.*

Gorman involved nuclear power plant employees seeking compensation for the 10 to 30 minutes a day spent in security checks at the plant’s entrance that were required for
all persons entering the plant, including
visitors; the Second Circuit affirmed a
district court’s Rule 12 dismissal. The
Second Circuit’s analysis was different from
the Ninth Circuit’s in Integrity Staffing; it
explained that “[i]ndispensable’ is not
synonymous with ‘integral’,” and therefore
the fact that an employer required
employees to engage in certain activity only
establishes indispensability.

The Second Circuit did not consider whether
the activity benefited the employer. To be
integral, the activity at issue must be somehow joined or linked in other ways
with the employee’s principal activities, the
court explained. The court held that the
security activities required were “necessary
in the sense that they are required and serve
essential purposes of security; but they are
not integral to principal work activities.”
There are two things worth noting about
Gorman, however. First, the plaintiff’s
complaint did not “even mention what kind
of work [p]laintiff” did at the power plant.
Second, the court of appeals explained in a
footnote that the result may be different for
an employee whose principal activity was
“monitoring, testing and reporting on the
plant’s infrastructure security.”

Bonilla involved construction-workers
seeking compensation for time spent in
FAA-mandated security checks at the
entrance to a restricted portion of the airport
where they were working; the Eleventh
Circuit affirmed the district court’s order
granting summary judgment to the
employer. Like the Second Circuit, the
Eleventh Circuit explained that the necessity
of going through the security screening was
insufficient standing alone to make the time
compensable. The court concluded, in order
to be compensable “the activity in question
must be work in the benefit of the
employer,” and the FAA-mandated security
screening was not.

The Supreme Court’s Opportunity to
Clarify What it Means for an Activity to
be "Integral and Indispensable" to an
Employee’s Principal Activity

In today’s environment, it is the rare
employer that does not have some sort of
security process for employees entering
and/or leaving the work location, even if that
process merely involves swiping an
identification badge. Participation in such
security processes is invariably required of
employees, and those processes undoubtedly
benefit the employer. The Portal to Portal
Act clearly excludes the time an employee
travels to and from the place where she
performs her principal activities from
compensable time, however.

But, under the Ninth Circuit’s decision,
employee participation in a simple security
screening may be sufficient to support a
claim that the time traveling from point A
(i.e., the security screen at the beginning of
the workday) to B (i.e., the place where the
employee performs her principal activities)
— and the time traveling from point B back
to A at the end of the workday — is
compensable.

Integrity Staffing provides the Supreme
Court an opportunity to more specifically
articulate what it means for an activity
occurring at the beginning or end of an
employee’s workday to be integral and
indispensable to an employee’s principal work activity. The court’s existing case law requires that there must be some relationship between the activity at issue and the principal activities the employee is paid to perform. But, as the Eleventh Circuit observed in *Bonilla*, the statute “does not allow for a clean analytical distinction between those activities that are ‘integral and indispensable’ and those that are not.” Whatever test the Supreme Court may adopt, it should not be sufficient, as the Ninth Circuit suggests is the case, that the activity be required by and for the benefit of the employer in order for it to be compensable — something more should be required.

The Ninth Circuit’s approach in *Integrity Staffing* is unworkable and inconsistent with the Supreme Court’s jurisprudence. If the activity is required by someone other than the employer, as the court in *Bonilla* observed, then that activity certainly should not be compensable. But the fact that an activity is required by an employer does not logically lead to the conclusion that the activity is integral and indispensable to the employee’s principal activities.

The activity may be required by virtue of the employment relationship itself (e.g., all employees must swipe a security badge to enter the building) or by virtue of the employee’s work location (e.g., all employees assigned to work in a particular location must pass through security for safety reason). In either case, performance of the activity may not facilitate the principal activities the employee is paid to perform, other than to allow him access to his workplace. The question, instead, should be whether the activity is required (i.e., indispensable) for the employee to carry out his or her job, as was the case in *Mitchell* where the evidence revealed that “[s]harpening the knife is integral to carving a carcass.” Or in the case of an employee participating in a security screening, as suggested by the Second Circuit in *Gorman*, where the evidence reveals that her principal activity was “monitoring, testing and reporting on the plant’s infrastructure security.”

Similarly, the fact that an activity benefits an employer also does not logically lead to the conclusion that it is integral and indispensable to the employee’s principal activities. Rarely does an employer require anything of its employees without deriving some benefit. Requiring employees to park at the back of a parking lot, for example, so that customers can park closer to the facility benefits the employer, but has nothing to do with the employee’s principal activities. Requiring employees to wear a specific uniform certainly provides a benefit to the employer, and many employers require uniforms for all employees, regardless of their duties. But, it is already well-established that such a uniform requirement does not start the time clock running for all employees the moment they get dressed at home before their shift.

However the Supreme Court rules in *Integrity Staffing*, its decision will potentially have a wide-ranging impact on most large employers.
Warehouse workers subcontracted to Amazon.com can move forward with a lawsuit seeking wages for the time it takes them to pass through a security checkpoint at the end of their shift, a court ruled this month.

After the workday is over, employees at Integrity Staffing Solutions who spend the day at a warehouse filling Amazon orders are required to wait in line for a search to make sure they aren’t stealing anything. It takes about 20 to 25 minutes to get through the checkpoint, plaintiffs say, after they’ve already clocked out.

That’s nearly two hours or more every week spent at work that isn’t being compensated. Alleging that the practice violates federal labor rules, former employees Jesse Busk and Laurie Castro initiated a class action lawsuit against Integrity to recoup the difference.

A district court stepped in and dismissed the suit, but earlier this month the 9th U.S. Circuit Court of Appeals gave the class action the green light to advance. The plaintiffs “allege that the screenings are intended to prevent employee theft – a plausible allegation since the employees apparently pass through the clearances only on their way out of work, not when they enter,” the opinion says. “As alleged, the security clearances are necessary to employees’ primary work as warehouse employees and done for Integrity’s benefit.”

However, the 9th Circuit upheld the District Court’s dismissal of a portion of the suit seeking compensation for the time it took to walk to the employee lunch area.

**Time on the Clock**

The federal Fair Labor Standards Act mandates that workers get paid for “all time during which an employee is necessarily required to be on the employer’s premises, on duty or at a prescribed work place,” which may “be longer than the employee’s scheduled shift, hours, tour of duty, or production line time.” Work time includes periods during which an employee is “engaged to wait” for an employment-related activity.

Other courts have found that employees do not have to be compensated for the time it takes to pass through security. However, in those instances the checks were made uniformly in the interest of safety, such as for workers at an airport or other sensitive facilities.

The distinction in the Busk-Castro suit is that the checks were made solely to protect the employer’s interest in not having merchandise stolen, and therefore could count as time on the clock, the 9th Circuit reasoned.

“Postliminary activities are still compensable . . . if they are ‘integral and indispensable’ to an employee’s principal activities,” the opinion states, comparing the
Integrity checks to situations in which employees are required to put on and take off specialized outfits on the premises of a job.

If Integrity doesn’t want to pay for the extra 20 minutes, they could reduce the amount of time it takes to leave the warehouse. “There are thousands of employees all going through the gates at the same time,” says Mark Thierman, a labor and employment attorney at the Reno-based Thierman Law Firm, which is representing the plaintiffs. “They could relieve it by opening more checkpoints or staggering releases.”

**Head of the Class**

The class potential could be huge. “We estimate there’s over 38,000 Amazon workers employed by Integrity or other subcontractors,” Thierman says. Taking into account employee turnover, the total number could approach 100,000 members.

The statute allows for compensation to be sought for the previous three years, although the attorneys are hoping to extend the period to five years given the time it took to appeal the dismissal.

Most of the workers affected make between $9 and $12 an hour. “If you want to take the pencil to paper we’re talking hundreds of millions of dollars,” the lawyer says.

Current or former Integrity employees eligible to join the class need to opt in to the lawsuit by filing a consent to sue form or contacting the attorneys. “The bottom line,” says Thierman, “is people are going to get some serious money if they participate.”
The Ninth Circuit ruled Friday that Fair Labor Standards Act collective action and state law class action claims were not inherently incompatible, reviving a lawsuit accusing Integrity Staffing Solutions Inc. of illegally failing to pay warehouse workers for time spent waiting to clear security checkpoints.

A three-judge appellate panel issued a published opinion that partially reversed a Nevada district judge's ruling that said former Integrity workers Jesse Busk and Laurie Castro failed to state valid claims under the FLSA and that their Nevada law claims had to be dismissed because of conflicting class certification mechanisms under the FLSA and Federal Rule of Civil Procedure 23, which governs class actions.

The panel fell into step with its sibling circuits' reasoning that the text of the FLSA — which calls for class members to opt in to the suit — doesn't suggest that a district court had to dismiss state law class claims governed by the usual opt-out mechanism, under which class members are covered unless they affirmatively exclude themselves.

“We agree with all other circuits to consider the issue that such actions can peacefully coexist. Therefore, the district court erred in dismissing the state law claims based on a perceived conflict,” the panel held.

The panel — ruling on a challenge to an order granting a motion to dismiss — also shot down the lower court's finding that the plaintiffs hadn't stated a valid FLSA claim based on post-shift time workers had to spend passing through security checkpoints allegedly meant to deter theft. However, the panel agreed with the trial court that the plaintiffs hadn't stated a claim under the FLSA for shortened lunch periods.

Busk and Castro worked at warehouses in Nevada filling orders placed by Amazon.com customers, court papers said. Busk filed the suit in October 2010, and both plaintiffs lodged an amended complaint in December 2010, alleging that workers had to wait up to 25 minutes at the end their shifts to passed through a theft-deterrent “post 9/11 type” of security clearance that involved removing wallets, keys and belts, and passing through metal detectors.

They also sought compensation under the FLSA and federal law based on the fact that they had to spend 10 minutes of their 30-minute unpaid meal breaks moving to and from a cafeteria. The plaintiffs and others like them were entitled to regular pay for all hours worked and premium pay for any overtime hours, the amended complaint said.

Although the question of whether there's a conflict between the opt-out FLSA claims and opt-in state law class claims is interesting, the Ninth Circuit's ruling was very significant because of what it said about whether time spent waiting to clear security checkpoints can coexist with state class claims.
security checkpoints was compensable, said Mark Thierman of the Thierman Law Firm PC, which represents the plaintiffs. Making employees wait to go through security without paying them after shifts is a common practice, according to Thierman.

“It's a huge case for the real world, and not just the legal world,” Thierman said of the Integrity Staffing matter.

The panel said that the district court dropped the ball by assuming that there was a “blanket rule” that security clearance time isn't compensable, as opposed to applying the appropriate test.

The appeals court said that the lower court had found that the plaintiffs' waiting time wasn't compensable based on “out-of-circuit cases.” Here, the plaintiffs' allegation that the security screenings are meant to stop theft is plausible, because they only had to go through such screenings when they left work, not when they arrived, the appeals court noted. In the cases the district court relied on, employees had to pass through security when entering the workplace, the panel said.

“As alleged, the security clearances are necessary to employees’ primary work as warehouse employees and done for Integrity's benefit,” the panel held.

An attorney for Integrity declined to comment.
Robert J. MacLean petitions for review of a final decision of the Merit Systems Protection Board (“Board”), which sustained the Transportation Security Administration's (“Agency's”) removal of Mr. MacLean from the position of Federal Air Marshal (“Marshal”). Because the Board incorrectly interpreted the Whistleblower Protection Act (“WPA”), we vacate and remand.
public.” He complained to his supervisor and to the Office of Inspector General, but they responded that nothing could be done. Dissatisfied, Mr. MacLean told an MSNBC reporter about the directive so as to “create a controversy resulting in [its] rescission.” MSNBC published an article criticizing the directive, and the Agency withdrew it after several members of Congress joined in the criticism.

In 2004, Mr. MacLean appeared on NBC Nightly News in disguise to criticize the Agency dress code, which he believed allowed Marshals to be easily identified. However, someone from the Agency recognized his voice. During the Agency’s subsequent investigation, Mr. MacLean admitted that he revealed the cancellation directive to an MSNBC reporter in 2003. Eventually, Mr. MacLean was removed from his position because his contact with the MSNBC reporter constituted an unauthorized disclosure of sensitive security information (SSI). Although the Agency had not initially labeled the text message as SSI when it was sent, it subsequently issued an order stating that its content was SSI.

Mr. MacLean challenged the SSI order in the Ninth Circuit as a violation of the Agency's own regulations and as an impermissible retroactive action, but the court rejected Mr. MacLean's challenges. It held that substantial evidence supported designating the text message as SSI under the applicable regulations, and that the Agency did not engage in retroactive action because it “applied regulations ... in force in 2003” to determine that the text message was SSI.

Mr. MacLean challenged his removal before the Board, arguing that his disclosure of the text message was protected whistleblowing activity. After an interlocutory appeal from the Administrative Judge (AJ), the full Board determined that Mr. MacLean's disclosure fell outside the WPA because it was “specifically prohibited by law.” The Board reasoned that the regulation prohibiting disclosure of SSI, upon which the Agency relied when it removed Mr. MacLean, had the force of law.

The AJ then upheld Mr. MacLean's removal and the Board affirmed in MacLean II, the decision now on appeal. Reconsidering MacLean I, the Board explained that a regulation is not a “law” within the meaning of the WPA. Instead, the Board held that the disclosure of the text message could not qualify for WPA protection because it was directly prohibited by a statute, the Aviation and Transportation Security Act (ATSA).

The Board also determined that the AJ applied the correct regulation in upholding the Agency's removal of Mr. MacLean, and that the penalty of removal was reasonable. Moreover, the Board upheld the AJ's finding that the Agency did not terminate Mr. MacLean in retaliation for his activities on behalf of the Federal Law Enforcement Officers Association (FLEOA) because the unauthorized disclosure of SSI was a non-retaliatory reason for removal. Therefore, the Board sustained the removal.

This appeal followed. We have jurisdiction under 28 U.S.C. § 1295(a)(9).

DISCUSSION
We must affirm the Board's decision unless it is “(1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) obtained without procedures required by law, rule, or regulation having been followed; or (3) unsupported by substantial evidence.” We review the Board's legal determinations de novo.

I. Application of Agency Regulations to Mr. MacLean's Removal

The Board explained that, “[u]nder the regulations in effect in July 2003, information relating to the deployment of [Marshals] was included within the definition of SSI,” and concluded that, as a result, Mr. MacLean's communication with a reporter constituted an unauthorized disclosure. Mr. MacLean argues, however, that the Board erred by upholding his removal because he was not charged under the right regulation. He explains that the regulation quoted in the initial charge, 49 C.F.R. § 1520.5(b)(8)(ii), was not in force in 2003 and only became codified in 2005. Mr. MacLean contends that the Board wrongly concluded that the regulation it ultimately relied on to uphold his removal, 49 C.F.R. § 1520.7(j), which was in force in 2003, is the same as the 2005 regulation. Mr. MacLean argues that the Board violated the rule of SEC v. Chenery Corp. because the Board affirmed his removal on grounds different from those under which he was initially charged by the deciding official.

Mr. MacLean also maintains that, although the Ninth Circuit upheld the Agency's eventual designation of the text message as SSI, his removal violated his due process rights because the message was not labeled SSI when it was sent. He argues that the termination was improper because he did not know that he was violating any Agency rules by revealing the content of the text message. Mr. MacLean admits that he signed a nondisclosure agreement as a condition of his employment, which states that Marshals “may be removed” for “[u]nauthorized release of security-sensitive or classified information.” He argues, however, that he believed that the message was not SSI and that, in any event, he was protected as a whistleblower. Repeating the argument rejected by the Board, Mr. MacLean thus insists that he tried in good faith to proceed within the law.

We do not find Mr. MacLean's arguments challenging the Agency's charge to be persuasive. The regulation that the Board ultimately relied upon to uphold Mr. MacLean's removal is no different from the regulation under which he was initially charged. The earlier regulation bars disclosing “[s]pecific details of aviation security measures,” including “information concerning specific numbers of [Marshals], deployments or missions,” while the latter prohibits revealing “specific details of aviation ... security measures” and “[i]nformation concerning deployments.” In fact, the regulation's history shows that § 1520.5(b)(8)(ii) is simply a recodified version § 1520.7(j). Because the Agency removed Mr. MacLean for revealing SSI, and the Board affirmed the termination for that same reason, the Board did not violate the Chenery doctrine.

We likewise reject Mr. MacLean's due process and “good faith” arguments. Both
the applicable regulation and the nondisclosure agreement that Mr. MacLean signed put him on notice that revealing information concerning coverage of flights by Marshals could lead to termination. Thus, the Agency did not violate due process even though it formally designated the text message as SSI only after it was sent. Furthermore, we agree with the government that, because the regulation prohibiting disclosure of SSI does not include an intent element, Mr. MacLean cannot be exonerated by his subjective belief that the content of the text message was not SSI or that he was protected as a whistleblower.

II. Reasonableness of Mr. MacLean's Removal

Mr. MacLean argues that the Board failed to adequately analyze the factors listed in *Douglas v. Veterans Administration* for possible mitigation of the penalty of removal. Mr. MacLean contends that the Board did not take into account the fact that he was a one-time offender and otherwise had an unblemished record. Mr. MacLean also argues that *Douglas's* “comparative discipline” factor did not weigh in favor of removal because other Marshals were not terminated even though they disclosed SSI regarding specific flights. Mr. MacLean contends that the Board ignored the fact that other Marshals' disclosures were for personal gain, while his disclosure exposed and led to correcting an Agency mistake. He thus argues that revealing the text message to a reporter served the public interest, and that his termination undermined the efficiency of the service.

The government counters that the Board did not abuse its discretion when it determined that Mr. MacLean's termination promoted the efficiency of the service. The government argues that there is no evidence that Mr. MacLean's actions made the flying public safer. The government contends that, because even a possibility that a Marshal may be onboard is an important deterrent to terrorist activity, Mr. MacLean's disclosure compromised flight safety and forced the Agency to reallocate scarce resources to address this new vulnerability. The government explains that, although Mr. MacLean was a first-time offender with a clean record, he was properly removed because his disclosure could have had catastrophic consequences. The government argues that Mr. MacLean differs from the Marshals who kept their jobs in spite of SSI breaches because those Marshals compromised only individual flights and showed remorse.

We agree with the government. The Board analyzed the relevant *Douglas* factors and did not abuse its discretion in concluding that Mr. MacLean's removal was not a disparate penalty. Unlike other Marshals, Mr. MacLean revealed that multiple flights would be unprotected, and we cannot say that it was unreasonable for the Board to find that Mr. MacLean's belief that he was doing the right thing was outweighed by the resulting threat to public safety. Moreover, it was not unreasonable for the Board to determine that Mr. MacLean's conduct “caused the [A]gency to lose trust in him,” because Mr. MacLean admitted that he has “no regrets” and “feels no remorse for going to a credible and responsible media
representative,” Given these circumstances, the Board did not abuse its discretion by upholding Mr. MacLean's removal.

III. Mr. MacLean's Prohibited Personnel Practice Claim

The Board rejected Mr. MacLean's argument that the Agency violated the Civil Service Reform Act by investigating him in retaliation for his FLEOA activities. The statute at issue prohibits individuals in positions of authority from discriminating against a government employee “on the basis of conduct which does not adversely affect the performance of the employee ... or the performance of others.” The Board concluded that Mr. MacLean's prohibited personnel practice challenge failed because he did not “meet his burden to establish that the reason articulated by the [A]gency was pretextual and that the real reason underlying that decision was his FLEOA activities.” Mr. MacLean reasserts his discrimination argument on appeal. He contends that the Agency investigated him because of his 2004 appearance on NBC Nightly News, which he made as part of his advocacy on behalf of FLEOA.

We agree with the government that substantial evidence supports the Board's conclusion that the Agency did not discriminate against Mr. MacLean on the basis of his FLEOA activities. Agency Policy Directive ADM 3700 “regulate[s] and prohibit[s] [Marshals'] unauthorized contact with the media,” and record evidence is consistent with the AJ's determination that Mr. MacLean was initially investigated for his unauthorized media appearance, not for his FLEOA activities. Indeed, it is undisputed that the Agency began to investigate Mr. MacLean “within days of his unauthorized appearance” on NBC Nightly News, which was “approximately 22 months after he began organizing and leading the [FLEOA] chapter.” Although the Agency ultimately did not pursue the media appearance charge and focused on the SSI disclosure charge, the initial investigation does not appear to be frivolous or pretextual because it was justified by Directive ADM 3700.

IV. Mr. MacLean's Affirmative Defense Under the WPA

The WPA prohibits individuals in positions of authority from taking a “personnel action” against a government employee in certain circumstances, particularly because of any disclosure of information by an employee ... which the employee ... reasonably believes evidences ... a substantial and specific danger to public health or safety, if such disclosure is not specifically prohibited by law ...

Board rejected Mr. MacLean's affirmative defense that his disclosure of the text message was protected whistleblowing activity because it determined that the disclosure was “specifically prohibited by law” within the meaning of the WPA. The law that the Board relied upon is the ATSA, which states, in relevant part:

Notwithstanding section 552 of title 5 ..., the Secretary of Transportation shall prescribe regulations prohibiting disclosure of information obtained or developed in ensuring security under this title if the Secretary of Transportation decides disclosing the
Because its conclusion that revealing the content of the text message was specifically prohibited by the ATSA made further WPA inquiry unnecessary, the Board did not reach the question of whether Mr. MacLean “reasonably believe[d]” that this information “evidence[d] ... a substantial and specific danger to public ... safety.”

The parties do not dispute that, in order to fall under the WPA's “specifically prohibited by law” proviso, the disclosure must be prohibited by a statute rather than by a regulation. Thus, the core of the disagreement is whether the ATSA “specifically prohibit[s]” disclosure of information concerning coverage of flights by Marshals within the meaning of the WPA.

Mr. MacLean and his amici (three members of Congress) argue that the Board erroneously concluded that the ATSA's mandate to the Secretary of Transportation to “prescribe regulations prohibiting disclosure” of certain kinds of information is a specific prohibition under the WPA. They contend that the phrase “specifically prohibited by law” in the WPA can only refer to explicit statutory language that identifies specific classes of information. They argue that the ATSA's “detrimental to transportation safety” language does not establish particular criteria for withholding information and leaves a great deal of discretion to the Agency, which is inconsistent with the WPA's requirement of specificity. They contrast the ATSA with the Trade Secrets Act, which directly authorizes removal of any federal employee who divulges information that falls into particular categories.

The government counters that Mr. MacLean violated a regulation promulgated pursuant to an express legislative directive in the ATSA, which made his disclosure “specifically prohibited” by a statute. It thus argues that Mr. MacLean's disclosure does not qualify for WPA protection. The government contends that Mr. MacLean's reading of the WPA eviscerates laws that provide for any Agency discretion in classifying information as SSI, and thus disables Congress from directing agencies to pass nondisclosure regulations. Lastly, the government argues that it does not make sense for Congress to order an agency to promulgate nondisclosure regulations and at the same time prohibit that agency from disciplining an employee for violating those regulations by providing a defense under the WPA.

We agree with Mr. MacLean that the ATSA does not “specifically prohibit” the disclosure at issue in this case. The ATSA's plain language does not expressly prohibit employee disclosures, and only empowers the Agency to prescribe regulations prohibiting disclosure of SSI “if the Secretary decides disclosing the information would ... be detrimental to public safety.” Thus, the ultimate source of prohibition of Mr. MacLean's disclosure is not a statute but a regulation, which the parties agree cannot be “law” under the WPA.

Notably, Congress changed the language “specifically prohibited by law, rule, or
regulation” in the statute's draft version to simply “specifically prohibited by law.” Congress did so because it was concerned that the broader language “would encourage the adoption of internal procedural regulations against disclosure, and thereby enable an agency to discourage an employee from coming forward with allegations of wrongdoing.” Congress explained that only “a statute which requires that matters be withheld from the public as to leave no discretion on the issue, or ... which establishes particular criteria for withholding or refers to particular types of matters to be withheld” could qualify as a sufficiently specific prohibition. In contrast, the “detrimental to transportation safety” language of the ATSA does not describe specific matters to be withheld. It provides only general criteria for withholding information and gives some discretion to the Agency to fashion regulations for prohibiting disclosure. Thus, the ATSA does not “specifically prohibit” employee conduct within the meaning of the WPA.

The ATSA's insufficient specificity becomes even more apparent when it is contrasted with statutes that have been determined to fall under the WPA's “specifically prohibited by law” proviso. For example, the Trade Secrets Act, which the Board in Kent held to qualify as a specific prohibition, is extremely detailed and comprehensive. That statute penalizes federal employees who “divulge[ ] ... any information coming to [them] in the course of [their] employment ... which information concerns or relates to the trade secrets, processes, operations, style of work, or apparatus, or to the identity, confidential statistical data, amount or source of any income, profits, losses, or expenditures of any person, firm, partnership, corporation, or association....” The same is true of § 6013 of the Internal Revenue Code, which the Ninth Circuit in Coons v. Secretary of the Treasury held to fall within the meaning of the WPA's “specifically prohibited” language. That statute prohibits federal employees from “disclos[ing] any return or return information obtained by him in any manner in connection with his service,” and then goes on to define “return” and “return information” in explicit detail, mentioning such things as “a taxpayer's identity, the nature, source or amount of his income, payments, receipts, deductions, exemptions, credits, assets, overassessments, or tax payments ...” Thus, when Congress seeks to prohibit disclosure of specific types of information, it has the ability to draft the statute accordingly.

Nonetheless, we note that the ATSA's charge to the Secretary of Transportation to prescribe regulations pursuant to specific criteria (i.e., only information that would be detrimental to transportation safety) makes this a very close case. Indeed, the ATSA appears to fall in the middle of the spectrum of statutes flanked at opposite ends by (a) those that fall squarely under the WPA's “specifically prohibited by law” proviso, such as the Trade Secrets Act and § 6013 of the Internal Revenue Code, and (b) those in which Congress delegates legislative authority to an administrative agency without circumscribing the agency's discretion. Regulations promulgated pursuant to Congress's express instructions would qualify as specific legal prohibitions.
In this case, given the clarity of the statutory language and legislative intent behind the WPA's specificity requirement, the parameters set by Congress are not enough to push the ATSA over that threshold.

We are similarly unpersuaded by the government's argument that a parade of horribles necessarily follows our adoption of Mr. MacLean's interpretation of the WPA. The government argues that, if Mr. MacLean is allowed to pursue his whistleblower defense, the WPA would in effect prohibit later Congresses from directing agencies to pass nondisclosure regulations. The government is concerned that, under Mr. MacLean's reading, the WPA would prohibit agencies from disciplining employees for violating nondisclosure regulations and thereby prevent agencies from enforcing such regulations.

The government is mistaken. In spite of the WPA, Congress remains free to enact statutes empowering agencies to promulgate and enforce nondisclosure regulations, and it has done so in the ATSA. The government ignores the fact that the ATSA covers a wide range of conduct that would not qualify as whistleblowing. For example, no one disputes that the ATSA empowers the Agency to promulgate regulations that enable it to discipline employees who reveal SSI for personal gain or due to negligence, or who disclose information that the employee does not reasonably believe evidences a substantial and specific danger to public health or safety. The WPA also does not prohibit the Agency from following the ATSA's mandate to regulate public access to information that the Agency might otherwise be forced to disclose under the Freedom of Information Act (FOIA). Indeed, it appears that the paramount goal of the ATSA is to empower the Agency to reject the public's requests for Agency intelligence because the statute recites that, “[n]otwithstanding [FOIA] ..., the Secretary of Transportation shall prescribe regulations prohibiting disclosure of information obtained or developed in ensuring security under this title.” Our interpretation of the WPA does not deprive the ATSA of meaning.

CONCLUSION

Because Mr. MacLean's disclosure is not “specifically prohibited by law” within the meaning of the WPA, we vacate the Board's decision and remand for a determination whether Mr. MacLean's disclosure qualifies for WPA protection. For example, it remains to be determined whether Mr. MacLean reasonably believed that the content of his disclosure evidenced a substantial and specific danger to public health or safety.

VACATED AND REMANDED

WALLACH, Circuit Judge, concurring.

Mr. MacLean presented substantial evidence that he was not motivated by personal gain but by the desire to protect the public. He averred proof that he sought direction from his supervisors before making allegedly protected disclosures. While I join in the analysis and the result of the majority opinion, I concur to emphasize that the facts alleged, if proven, allege conduct at the core of the Whistleblower Protection Act.
The Supreme Court said Monday that it will decide an important question of when a federal employee may release to the public sensitive information from his agency that he feels endangers fellow citizens.

The court agreed to a request from the Obama administration that the justices review a lower court’s decision that a federal air marshal may have been unfairly fired for going to the media about a security plan with which he disagreed.

Robert J. MacLean was an air marshal in 2003. Just after being briefed about a potential terrorist attack, MacLean said he received another message from the Transportation Security Administration: that because of a budget shortfall, the agency was cutting back on overnight trips for undercover air marshals.

MacLean said he went to his boss, who told him to keep quiet. Instead, he leaked the information to a reporter for MSNBC. This caused a congressional uproar, and the Department of Homeland Security canceled the order within 24 hours, calling it “premature and a mistake.”

MacLean’s response was that he should not have been fired for actions that others found heroic and were not unlawful.

“Robert MacLean was a federal air marshal who spoke up about the consequences of a dangerous and possibly unlawful government decision,” wrote Washington lawyer and former deputy solicitor general Neal Katyal.

“Because he blew the whistle, the government changed policy and a potential tragedy was averted. But Mr. MacLean paid a hefty price.”

According to MacLean’s brief, Sen. Barbara Boxer (D-Calif.) thanked the anonymous tipster “who came forward and told the truth.”

MacLean’s identity was not discovered until three years later, when he appeared on an NBC Nightly News program about a different incident.

His disguise on that broadcast “proved to be inadequate,” the government’s brief says, and the TSA fired him for disclosing sensitive security information.

The appeals court said MacLean was entitled to argue that he was
protected as a whistleblower and that his disclosure had not been “specifically prohibited by law.” The government said the regulations passed by the agency, which it contends prohibited MacLean’s actions, were authority enough to fire the air marshal.

MacLean had contended that the plan about eliminating overnight trips was not considered sensitive by the agency; it had been sent unencrypted to his cellphone.

The case, Department of Homeland Security v. MacLean, will be heard sometime during the court’s term that begins next October.
“Is Hike in Whistleblower Claims a Sign of Progress or Growing Mistrust?”

Federal News Radio
Jack Moore
May 20, 2014

Not quite two years ago, President Barack Obama signed into law a sweeping update to whistleblower protections for civilian federal employees.

The Whistleblower Protection Enhancement Act expanded the authority of both the Office of Special Counsel and the Merit Systems Protection Board to review employees' claims of agency wrongdoing and made it easier to discipline agency officials who retaliate against whistleblowers.

Both agencies have seen their caseloads skyrocket since the law went into effect.

But are the growing claims of retaliation evidence of a crackdown on whistleblowing employees or that more employees actually feel comfortable coming forward to report agency misconduct?

The heads of both OSC and MSPB told Federal News Radio as part of the special report, Trust Redefined: Reconnecting Government and Its Employees, that their increasing workloads could actually be a sign of progress — that more employees feel protected now to make disclosures.

"If people can come forward and report waste, fraud or abuse — or health and safety problems — it makes our government stronger," said Carolyn Lerner, head of the OSC, in an interview with Federal Drive hosts Tom Temin and Emily Kopp.

"When we have an environment and an atmosphere where employees are rewarded instead of punished for coming forward, I think that creates a better culture and it certainly creates a more effective government."

Still, an exclusive Federal News Radio survey reveals a wide chasm of trust remains when it comes to feds blowing the whistle at work. Just 16 percent of respondents to the survey said they felt protected enough to report waste, fraud or abuse at their agencies even with the recent changes in law.

"Retaliation for whistleblowing is alive and well, despite supposed legal protections," one respondent said.

Agencies hit with wave of new whistleblower claims

Lerner said OSC has seen an incredible uptick in its caseload over the last year or so as more employees come to the agency alleging that they've been retaliated against for reporting agency misconduct.

Very often, "after somebody blows the whistle, the terms or conditions of their employment change," Lerner said. "It can be something like a hostile work environment. It can be up to and including termination."

So far, in fiscal 2014, the agency has received more than 1,700 complaints of prohibited personnel practices, about half of
which involve retaliation for whistleblowing, she said.

Lerner's agency wasn't the only one to be hit with an increased workload following recent changes in the law.

Whistleblower claims filed with MSPB have more than doubled in recent years, according to the board's chairwoman, Susan Tsui Grundmann.

But there may be more than the new law at work that explains the rise in cases, she said.

"The reason why I suspect we're seeing more claims may have less to do with changes in the law and more to do with a greater awareness of a federal employee's rights to file in this area," she told Federal Drive hosts Tom Temin and Emily Kopp.

For one thing, whistleblower organizations and good-government groups have helped raise awareness of whistleblowing concerns, she said.

Agencies are also attempting to do their part.

"At the same time, agencies are a lot sharper in terms of getting the word out, training people [on] what's protected, what's not protected and your venue to redress your claims," Grundmann said.

**Do agencies' whistleblower practices pass muster?**

OSC runs training workshops to brief managers on their responsibilities under the whistleblower laws and to educate employees about their rights, including the fact that retaliation against whistleblowers is a prohibited personnel practice.

The ultimate goal of OSC's outreach efforts is to change the conversation — the climate — around whistleblowing.

"No one likes to be criticized; no one likes to feel like they are being called out for doing something wrong," Lerner said. "But the more we can create a climate where disclosures are viewed as ultimately a good thing, as an employee trying to do what's right for the agency and for the government and, frankly, for our country, the better things will be. If we can help agencies create that climate of openness where employees feel like coming forward as valued, that will help trust."

That will also have a very practical impact, she suggested.

"I'm convinced that more education and outreach will help prevent misunderstandings and mistakes and, ultimately, result in fewer complaints needing to be filed in the first place."

Shirine Moazed, chief of OSC's Washington, D.C., field office, oversees a team responsible for training federal managers and ensuring an agency's whistleblower practices pass muster.

Moazed said the trainings emphasize that education is an essential step in preventing whistleblower retaliation — and other prohibited practices — and that such education must start at the top.

"So, if the head of the agency and the head of the components make it very significant that their supervisors be trained and train others on the prohibitions against whistleblower retaliation, that's something
that's going to generate interest and understanding throughout the agency," she told In Depth with Francis Rose.

'There are no real protections in place'

But despite the recent changes to law and the outreach efforts across government, it appears many would-be whistleblowers still don't feel protected enough to disclose potential wrongdoing. Just 14 percent of respondents to an exclusive Federal News Radio survey agreed that there are enough protections in place for whistleblowers to feel safe to report waste, fraud and abuse.

"In print and in theory, yes, there are enough protections in place for federal whistleblowers," one respondent said. "In reality, there is not because of the real possibility of retaliation from management and/or the agency."

Another respondent presented an even gloomier perspective.

"There are no real protections in place. It is all lip service. All the employees who have come forward in recent memory have their careers destroyed ... or they were punished with career-ending reassignments."

While fewer than 22 percent of respondents said they had personally reported waste, fraud or abuse at their agency, 44 percent of those who did said they were retaliated against in some form.

Those findings are similar to a 2011 MSPB report on whistleblower retaliation. The report indicated that while employees' perceptions of agency wrongdoing had actually declined between 1992 — when MSPB first studied the issue — to 2011, the overall perception that employees would be retaliated against for speaking out had not.

About 36 percent of respondents said they were retaliated against or threatened with retaliation for reporting agency misconduct, according to the MSPB study.
The Federal Circuit stressed Friday that government whistleblowers are protected by federal law unless their disclosures are explicitly prohibited by another statute, reviving the case of an air marshal who was fired for leaking policy changes to a reporter.

According to the opinion, Robert MacLean was terminated after he told an MSNBC reporter that the Department of Homeland Security planned to remove all marshals from flights in and out of Las Vegas for a short period in 2003—a change he thought endangered public safety.

Though several congressmen publicly came to his aid and the department eventually reversed course, the Merit Systems Protection Board later found that MacLean didn’t qualify for reinstatement as a bona fide whistleblower.

The Whistleblower Protection Act exempts protection for employees who break other laws when they come forward, and the department persuaded the MSPB that MacLean had violated the Aviation and Transportation Security Act by disclosing classified air marshal information to the reporter.

The Federal Circuit overturned that decision Friday, saying the WPA’s exemption was reserved for the release of classified information that a law specifically bans. More vague laws like the ATSA—which merely empowers an agency to create nondisclosure regulations—don’t make that cut, the court said.

“No, Congress changed the language ‘specifically prohibited by law, rule, or regulation’ in the [WPA]’s draft version to simply ‘specifically prohibited by law,’” the appeals court said.

“Congress did so because it was concerned that the broader language would encourage the adoption of internal procedural regulations against disclosure, and thereby enable an agency to discourage an employee from coming forward with allegations of wrongdoing,” the panel added.

In contrast, similar but more direct provisions under laws like the Internal Revenue Code—which bans employees from disclosing a private tax return for any reason—are specific enough to qualify under the WPA’s exemption, the court wrote.

“When Congress seeks to prohibit disclosure of specific types of information, it has the ability to draft the statute accordingly,” the court said.

The opinion also rejected Department of Homeland Security’s argument that MacLean’s tougher interpretation of the WPA would effectively neuter Congress’ ability to empower government agencies to implement and enforce nondisclosure laws.
Under the court’s reading of the WPA, agencies can still punish and fire employees from disclosing information for personal gain or out of negligence and can pass rules to limit their exposure to Freedom of Information Act requests, the court said. What they can’t do, the court said, is punish an employee for blowing the whistle by releasing information that Congress hasn’t specifically barred.

Though a win for MacLean, Friday’s ruling does not a whistleblower make. With the proper interpretation of the WPA established, the appeals court remanded the case back to the MSPB to determine other prongs of the whistleblower test, like whether MacLean made his disclosure because he believed the department’s policy posed a legitimate threat.

Writing a one-paragraph concurring opinion, U.S. Circuit Judge Evan Wallach agreed with the ruling of the majority but used stronger language to stress the high bar for exempting disclosures from protection.

“I concur to emphasize that the facts alleged, if proven, allege conduct at the core of the Whistleblower Protection Act,” Wallach wrote.

In a statement on Monday, MacLean said the ruling—alongside last year’s Whistleblower Protection Enhancement Act—would mean that whistleblowers will have “significantly more confidence to expose wrongdoing without the fear of being marginalized or suffering financial hardship.”

“An honest employee with the fortitude to expose corruption should expect to make sacrifices, but no one should have to endure seven or more years of aggravation,” MacLean said.

A representative for the Department of Homeland Security didn’t immediately return a request for comment on the decision.

Judges Sharon Prost, Kimberly Moore and Wallach sat on the panel, with Moore penning the majority opinion.

MacLean was represented by Lawrence Berger of Mahon and Burger and by Thomas M. Devine of Government Accountability Project.

The case was Robert J. MacLean v. Department of Homeland Security, case number 11-3231, in the U.S. Court of Appeals for the Federal District.
**Comptroller v. Wynne**

13-485


Individual state-resident taxpayers sought judicial review of Tax Court decision that affirmed, against a Commerce Clause challenge, assessment by state comptroller of county income tax without a credit for payment of out-of-state income taxes. Following a hearing, the Circuit Court, Howard County, Louis A. Becker, III, J., reversed decision of Tax Court and remanded case. After an appeal was noted to the Court of Special Appeals, the Court of Appeals granted certiorari.

**Question Presented:** Whether the United States Constitution prohibits a state from taxing all the income of its residents -- wherever earned -- by mandating a credit for taxes paid on income earned in other states.

**MARYLAND STATE COMPTROLLER OF the TREASURY**

v.

**Brian WYNNE, et ux.**

Court of Appeals of Maryland

Decided on January 28, 2013

[Excerpt; some footnotes and citations omitted.]

**McDONALD, Judge**

Federal and Maryland law allow for the attribution of corporate income to the corporation's shareholders—without being taxed at the corporate level—in defined circumstances. In particular, the income of a Subchapter S corporation is deemed to "pass through" to the shareholders who are then directly taxed on that income. Some or all of that income may be generated outside the state in which a shareholder resides.

The Maryland income tax law reaches all of the income of a Maryland resident. The State income tax law allows a credit against an individual's State tax liability for income taxes paid to other states based on the income earned in those states. However, that credit takes no account of, and cannot be taken against, the portion of the Maryland income tax known as the "county income tax."

This case poses the question whether the failure to allow a credit violates the federal Constitution when a portion of a Maryland resident taxpayer's income consists of significant "pass-through" income generated by a Subchapter S corporation in other states, apportioned to the taxpayer, and taxed by the states in which it was
The taxpayer has appealed an assessment by the State Comptroller that did not allow a credit against the county income tax portion of the Maryland income tax.

The Comptroller, as he should, defends the tax law as written by the Legislature and interpreted by this Court. The taxpayers accept that interpretation, but assert that it is wanting when measured against the federal Constitution. They rely on a multitude of cases—virtually all of which are subsequent to the 1975 amendment of the Maryland tax law that uncoupled the credit from the county income tax—that assess state taxes against what has come to be known as the “dormant Commerce Clause.”

Although the Maryland Tax Court ruled in favor of the Comptroller, the Circuit Court for Howard County reversed that decision and held that the statute's failure to allow such a credit violated the dormant Commerce Clause. For the reasons that follow, we find merit in the taxpayers' contentions and affirm the judgment of the Circuit Court.

**Background**

**State Income Taxes**

A state may tax the income of its residents, regardless of where that income is earned. A state may also tax a nonresident on income earned within the state. Both of these propositions are consistent with the Due Process Clause of the Fourteenth Amendment. However, they raise the possibility of what might be termed “double taxation” when both the state of the taxpayer's residence and the state where the income was generated tax the same income.

As explained below, the Commerce Clause of the federal Constitution sets certain constraints on this possibility, which the states recognize through the provision of credits for payments of out-of-state taxes.

**Maryland Individual Income Tax**

State law imposes an income tax on individuals. It is composed of three parts:

1. a State income tax (the “State tax”) at a rate set by the Legislature in statute;
2. a county income tax that applies only to residents of each county (the “county tax”) at a rate set by the county within the range allowed by statute; and
3. a tax on those subject to State income tax but not the county tax (the “Special Non–Resident Tax” or “SNRT”) at a rate equal to the lowest county tax.

Thus, all individual taxpayers are subject to the State tax and either the county tax or the SNRT. These taxes are all collected by the Comptroller; the proceeds of the county tax are distributed to the relevant county.

**Credit for Income Taxes Paid to Other States**

State law allows for an individual subject to the Maryland income tax to take a credit against the State tax for similar taxes paid to other states. In particular:

a resident may claim a credit only against the State income tax for a taxable year in the amount determined under [TG § 10–703(c)] for State tax on income paid to another state for the year. There are various exceptions to this credit, none of which are pertinent to this case. In general, the credit is
designed to ensure that Maryland receives, at a minimum, the Maryland income tax due on the taxpayer's income that is attributable to Maryland, regardless of the another state's method or rate of taxation.

No credit is given against the county tax for income taxes paid in other states. As this Court outlined in Blanton, a credit had previously applied with respect to the county tax. However, in 1975, the Legislature amended the tax code to eliminate that credit.

**S Corporations and Income Taxes**

A Subchapter S corporation or “S corporation” is a corporation—often a relatively small business—that meets certain requirements set forth in the Internal Revenue Code and makes an election to pass through its income and losses, for federal tax purposes, to its shareholders. Each shareholder reports his or her share of the S corporation’s income and losses on their individual tax returns and is assessed federal income tax at the shareholder's individual rate. In that way, the income that the S corporation generates for its owners is taxed at one level—similar to the taxation of a partnership—rather than at two levels (corporate and shareholder) as is otherwise typically the case. To accomplish this, the character of any item of income or loss of an S corporation “passes through” to its owners “as if that item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation.”

Some states accord similar pass-through treatment to the income of an S corporation; other states do not and require an S corporation to pay income tax directly. The Maryland income tax law incorporates, for the most part, the definitions of income under the Internal Revenue Code. Accordingly, the income of an S corporation “passes through” and is attributed to its shareholders for purposes of the Maryland income tax law.

**The Wynnes and Maxim Healthcare Services**

The underlying facts are undisputed. The taxpayers are Brian and Karen Wynne (“the Wynnes”), a married couple with five children residing in Howard County. During the 2006 tax year, Brian Wynne was one of seven owners of Maxim Healthcare Services, Inc. (“Maxim”), a company that does a national business providing health care services, and owned 2.4% of its stock. Maxim had made an election under the Internal Revenue Code to be treated as an S corporation. As a result of that election, Maxim's income was “passed through” to its owners for federal income tax purposes, and the Wynnes reported a portion of the corporation's income on their individual federal income tax return.

Because Maryland accords similar pass-through treatment to the income of S corporations, the Wynnes also reported pass-through income of Maxim on their 2006 Maryland tax return. A substantial portion of the pass-through income had been generated in other states and was taxed by those states for the 2006 tax year.

In particular, for the 2006 tax year, Maxim filed state income tax returns in 39 states.
Maxim allocated to each shareholder a pro rata share of taxes paid to the various states. The returns did not indicate payments of income taxes to any county or local entity in other states. The Wynnes claimed their pro rata share of such income taxes paid to other states as a credit pursuant to TG § 10–703(c) against their 2006 Maryland individual income tax, reflected on Maryland Form 502.

Assessment and Appeal

The Comptroller made a change in the computation of the local tax owed by the Wynnes and revised the credit for taxes paid to other states on the Wynnes' 2006 Maryland Form 502. The net result was a deficiency in the Maryland taxes paid by the Wynnes, and the Comptroller issued an assessment, which the Wynnes appealed.

On October 6, 2008, the Hearings and Appeals Section of the Comptroller's Office affirmed the assessment, although it revised it slightly. The Wynnes then appealed to the Maryland Tax Court where they argued, for the first time, that the limitation of the credit to the State tax for tax payments made to other states discriminated against interstate commerce in violation of the Commerce Clause of the United States Constitution. The Tax Court rejected that argument and affirmed the assessment on December 29, 2009.

The Wynnes then sought judicial review in the Circuit Court for Howard County. Following a hearing on the appeal, the Circuit Court reversed the Tax Court in a decision issued on June 29, 2011. The Circuit Court remanded the case to the Tax Court for further factual development and “an appropriate credit for out-of-state income taxes paid” on Maxim's income. An appeal was noted to the Court of Special Appeals on July 22, 2011. Prior to hearing and decision in the intermediate appellate court, this Court granted certiorari.

Discussion

Standard of Review

The Tax Court is “an adjudicatory administrative agency in the executive branch of state government.” A decision of the Tax Court is subject to the same standards of judicial review as contested cases of other administrative agencies under the State Administrative Procedure Act. In undertaking such review, this Court directly evaluates the decision of the agency—in this case, the Tax Court.

When the Tax Court interprets Maryland tax law, we accord that agency a degree of deference as the agency that administers and interprets those statutes. In this case, the Tax Court's decision required the application and analysis of cases interpreting the United States Constitution. Because our review of its analysis turns on a question of constitutional law, we do not defer to the agency's determination.

The Dormant Commerce Clause

The Wynnes do not contest the State's authority to tax their income, wherever earned, under the Due Process Clause. Rather, they base their challenge to the Comptroller's assessment on what has come to be known as the “dormant Commerce Clause” of the United States Constitution. The dormant Commerce
Clause is a restriction on State power that is not explicitly articulated in the Constitution but that has been derived as a necessary corollary of a power specifically conferred on Congress by the Constitution.

The Commerce Clause provides Congress with the power to “regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” “Though phrased as a grant of regulatory power to Congress, the [Commerce] Clause has long been understood to have a ‘negative’ aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce.” This negative aspect of the Commerce Clause is an “implied limitation on the power of state and local governments to enact laws affecting foreign or interstate commerce.”

We assess first whether the dormant Commerce Clause is implicated by the county tax and, if so, whether the failure to provide a credit for out-of-state taxes violates the dormant Commerce Clause.

**Does the Application of the County Tax without a Credit Implicate the Dormant Commerce Clause?**

Although each of the three components of the State income tax has its own label and is created by different code provisions, each is for federal constitutional purposes a state income tax. In any event, whether the tax is nominally a state or county tax is irrelevant for purposes of analysis under the dormant Commerce Clause because a state may not unreasonably burden interstate commerce through its subdivisions any more than it may at the state level.

Much recent case law concerning the dormant Commerce Clause has been “driven by concern about economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.” While many cases construing the dormant Commerce Clause concern state taxation, “[t]he dormant Commerce Clause protects markets and participants in markets, not taxpayers as such.” Therefore, the dormant Commerce Clause will not affect the application of a tax unless there is actual or prospective competition between entities in an identifiable market and state action that either expressly discriminates against or places an undue burden on interstate commerce. This impact must be more than incidental.

The Comptroller argues that the county income tax is not directed at interstate commerce and that the Wynnes have failed to identify any interstate commercial activity affected by a failure to allow a credit against that tax for tax payments to other states. However, application of the dormant Commerce Clause is not limited to circumstances where physical goods enter the stream of commerce. For example, a state tax exemption related to the movement of people across state borders for economic purposes has been held to implicate interstate commerce and violate the dormant Commerce Clause. Moreover, even when a state tax is imposed on an intrastate activity, if that tax substantially affects interstate commerce...
commerce, the tax is subject to scrutiny under the Commerce Clause.

The Comptroller asserts that the Wynnes are subject to Maryland income taxes because of their status as Maryland residents and not because of their activities in intrastate or interstate commerce. But this is a false dichotomy. In fact, they are subject to the income tax because they are Maryland residents and because they have income derived from intrastate and interstate activities; other states may also tax some of that same income because it derives from activities in those state. This case concerns the constitutional constraint on the otherwise overlapping power to tax such income.

In making his argument based on a state's power to tax its own residents, the Comptroller relies on several cases from other states that fail to distinguish the constraints on state taxation imposed by the dormant Commerce Clause from those imposed by the Due Process Clause or that are otherwise distinguishable from the case. Those cases are not persuasive.

The limitation of the credit for payments of out-of-state income taxes to the State portion of the Maryland income tax can result in significantly different treatment for a Maryland resident taxpayer who earns substantial income from out-of-state activities when compared with an otherwise identical taxpayer who earns income entirely from Maryland activities. In particular, the first taxpayer may pay more in total state and local income taxes than the second. This creates a disincentive for the taxpayer—or the S corporation of which the taxpayer is an owner—to conduct income-generating activities in other states with income taxes. Thus, the operation of the credit with respect to the county tax may affect the interstate market for capital and business investment and, accordingly, implicate the dormant Commerce Clause.

**Does Application of the County Tax without a Credit Violate the Dormant Commerce Clause?**

The Supreme Court has held that a state may tax interstate commerce without offending the dormant Commerce Clause so long as the tax satisfies a four-prong test. Under that test, a state tax survives a challenge under the dormant Commerce Clause if it:

1. applies to an activity with a substantial nexus with the taxing state;
2. is fairly apportioned;
3. is not discriminatory towards interstate or foreign commerce; and
4. is fairly related to the services provided by the State.

The Wynnes apparently do not dispute that the application of the county tax in this case has a substantial nexus to Maryland or that it is fairly related to services provided by the State. Thus, for purposes of the present controversy, we focus on the remaining two prongs of the *Complete Auto* test: the requirement of fair apportionment and the prohibition against discrimination against interstate commerce.

**Is the county tax without a credit fairly apportioned?**

The purpose of the apportionment requirement is to ensure that each state taxes only its fair share of an interstate
transaction. “It is a commonplace of constitutional jurisprudence that multiple taxation may well be offensive to the Commerce Clause. In order to prevent multiple taxation of interstate commerce, the Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value.” “The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile.... Otherwise there would be multiple taxation of interstate operations.”

The dormant Commerce Clause does not mandate the adoption of a particular income allocation formula for apportionment. In order to assess the fairness of apportionment courts look to whether a tax is “internally consistent” as well as “externally consistent.”

(a) Is the county tax without a credit internally consistent?

“Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every state in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.”

Internal consistency is thus measured by the answer to the following hypothetical question: If each state imposed a county tax without a credit in the context of a tax scheme identical to that of Maryland, would interstate commerce be disadvantaged compared to intrastate commerce?

The answer is yes. In this scenario, TG § 10–703 (or its hypothetical equivalent in other states) would grant a credit against a taxpayer's home state income tax but not against the home county income tax for income taxes paid to other states. As a result, taxpayers who earn income from activities undertaken outside of their home states would be systematically taxed at higher rates relative to taxpayers who earn income entirely within their home state. Those higher rates would be the result of multiple states taxing the same income.

This is illustrated by the following example.

- **Tax rates.** Assume each state imposes a state tax of 4.75% on all the income of its residents, a county tax of 3.2% on all the income of residents, and a SNRT of 1.25% on the income of non-residents earned within the state.

- **Credit.** Assume that each state allows a credit for income taxes paid to other states that operates in the same fashion as TG § 10–703—i.e., the formula for the credit and application of the credit take only the home state “state tax” into account.

- **Taxpayer with in-state income only.** Mary lives in Maryland and earns $100,000, entirely from activities in Maryland.

  Mary owes $4,750 in Maryland state income tax (.0475 x $100,000), $3,200 in Maryland county income tax (.032 x $100,000) for a total Maryland tax of $7,950.
• **Taxpayer with multi-state income.** John lives in Maryland and earns $100,000, half ($50,000) from activities in Maryland and half ($50,000) from activities in Pennsylvania.

Because John is a resident of Maryland, all of his income is subject to both the Maryland “state tax” and the “county tax” applicable to his county. Before the application of any credit, John owes $4,750 in Maryland state income tax (.0475 x $100,000), $3,200 in Maryland county income tax (.032 x $100,000) for a total Maryland tax of $7,950.

Because half of John's income was generated in Pennsylvania, John also owes $2,375 in Pennsylvania state income tax (.0475 x $50,000) and $625 with respect to the Pennsylvania SNRT (.0125 x $50,000) for a total Pennsylvania tax of $3,000.

John receives a credit in the amount of $2,375 with respect to his Maryland state income tax pursuant to credit formula set forth in TG § 10–703(c). This reduces his Maryland income tax to $5,575.

Thus, John owes a combined total of **$8,575** in state income taxes. As the above example demonstrates, a taxpayer with income sourced in more than one state will consistently owe more in combined state income taxes than a taxpayer with the same income sourced in just the taxpayer's home state. This may discourage Maryland residents from engaging in income-earning activity that touches other states. In the context of S corporations, it may encourage Maryland residents to invest in purely local businesses, and discourage businesses from seeking to operate both in Maryland and in other states. In effect, it acts as an extra tax on interstate income-earning activities. It fails the internal consistency test.

While it is true that a failure to pass the internal consistency test does not always signal a constitutional defect in a state tax scheme, the circumstances under which the courts have tolerated a lack of internal consistency do not pertain here. One such case concerned a flat $100 annual fee imposed by Michigan upon trucks engaged in intrastate commercial hauling. The petitioners in that case challenged the fee on the ground that it discriminated against interstate carriers and unconstitutionally burdened interstate trade because the fee was flat but trucks carrying both interstate and intrastate loads engaged in less intrastate business than trucks carrying only intrastate loads. The Supreme Court held that the fee did not violate the dormant Commerce Clause. In analyzing the internal consistency of the tax, the Court concluded that, if every state imposed such a fee, an interstate trucker doing local business in multiple states would have to pay hundreds or thousands of dollars in fees if it supplemented its interstate business by carrying local loads in many other states, thus an internal inconsistency. The Court nonetheless found no Commerce Clause violation because a business would have to incur such fees only because it engaged in local business in all those states. “An interstate firm with local outlets normally expects to pay local fees that are uniformly assessed upon all those who engage in local business, interstate and domestic firms alike.” Such a fee, in effect a toll on in-state activity, is factually distinguishable from the
present case involving business performed and income earned outside of Maryland. Moreover, we are not aware of an instance in which a court has upheld an unapportioned income tax on the authority of American Trucking.

The Comptroller advances an alternative argument. Because an individual can only be a resident of one county in the universe, even if every taxing jurisdiction adopted Maryland's tax structure, the individual would only be required to pay a county tax once. This, argues the Comptroller, precludes the possibility of multiple taxation by operation of the county tax. However, this analysis appears to be inconsistent with the logic underlying this Court's holding in Frey that the Maryland SNRT is a state tax for constitutional purposes. Moreover, under dormant Commerce Clause analysis, there are generally only two levels of regulation, state and federal. The Comptroller's analysis posits a third level, the local level, such that a local tax need only be considered in the light of local taxes in other jurisdictions. But there appears to be no authority in the case law for this position.

(b) Is the county tax without a credit externally consistent?

The next question is whether the current county tax scheme is externally consistent. For this test, one must assess "whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." This test looks to a state's "economic justification" for its claim on the value taxed "to discover whether a state's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing state." “[T]he threat of real multiple taxation (though not by literally identical statutes) may indicate a state's impermissible overreaching.”

Thus, to test for external consistency one asks: Does tax liability under the Maryland income tax code reasonably reflect how income is generated? Because no credit is given with respect to the county tax for income earned out-of-state, the Maryland tax code does not apportion income subject to that tax even when that income is derived entirely from out-of-state sources. Thus, when income sourced to out-of-state activities is subject to the county tax, there is a potential for multiple taxation of the same income. In those circumstances, the operation of the county tax appears to create external inconsistency. This is further indication that the application of the tax in these circumstances without application of an appropriate credit violates the dormant Commerce Clause.

(2) Does the County Tax Discriminate against Interstate Commerce?

Under the third prong of the Complete Auto test, a tax must not discriminate against interstate commerce. Even if a tax is fairly apportioned, it “may violate the Commerce Clause if it is facially discriminatory, has a discriminatory intent, or has the effect of unduly burdening interstate commerce.” A state tax may not discriminate against a transaction because the transaction has an interstate element or because the transaction or incident crosses state lines. A taxing scheme that encourages interstate businesses
to conduct more of their business activities within the taxing state may be found to be discriminatory. Facially discriminatory state taxes are subject to the strictest scrutiny, and the ‘burden of justification is so heavy that “facial discrimination by itself may be a fatal defect.’ ” There is no “de minimis” justification if a tax is found to actually discriminate against interstate commerce. Discriminatory effect may lie in the tax itself, but it may also arise from interactions with other states’ taxes.

Particularly pertinent to the present case is the Supreme Court's analysis of a North Carolina tax in Fulton Corp. v. Faulkner, supra. North Carolina imposed an “intangibles tax” on the value of corporate stock owned by North Carolina residents. The tax was computed as a fraction of the value of the stock, with the tax rate reduced to the extent that the corporation's income was subject to tax in North Carolina. This resulted in a North Carolina stockholder being taxed at a higher rate for holdings in companies that did not do business in North Carolina and at lower rates for holdings in companies that did business in North Carolina. The Supreme Court held that the tax violated the dormant Commerce Clause because it discriminated against interstate commerce. In striking down the tax, the Court stated: “[A] regime that taxes stock only to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents.....”

This case presents a similar situation. The application of the county tax to the out-of-state pass-through income without application of a credit for out-of-state income taxes on the same income means that Maryland shareholders—the Wynnes in this case—may be taxed at a higher rate on income earned through Maxim's out-of-state activities than on income earned though its Maryland activities. This would appear to favor businesses that do business primarily in Maryland over their competitors who do business primarily out-of-state—at least in the context of ownership of a Subchapter S corporation. The only difference between Fulton and the present case is one of form. Whereas in Fulton it was North Carolina's own tax rate that varied, in the present case it is the imposition of an additional tax, the tax set by the state where the income was earned—and the failure to provide a credit for it in Maryland—that creates the discrimination. Nonetheless, the effect is the same.

While the failure to allow a credit is at the heart of the discrimination in this case, not every denial of a deduction or credit for taxes paid to another jurisdiction results in a violation of the dormant Commerce Clause. In Amerada Hess v. New Jersey Dept. of the Treasury, the Supreme Court evaluated the constitutionality of a New Jersey statute that denied to oil-producing companies a deduction for amounts paid under the federal windfall profits tax. Holding that the tax did not violate the Commerce Clause, the Court noted, “a deduction denial does not unduly burden interstate commerce just because the deduction denied relates to an economic activity performed outside the taxing State.”
Amerada Hess is distinguishable from the present case however. At issue in Amerada Hess was a state deduction for a federal income tax—a tax that a business would be subject to no matter where it was located in the United States, whether within New Jersey or elsewhere. By denying a tax credit in that case, New Jersey treated all similarly-situated taxpayers equally because a business was subject to the same rate regardless of whether the windfall profits were earned within New Jersey or elsewhere. By contrast, the failure to provide a credit against the county tax in this case penalizes investment in a Maryland entity that earns income out-of-state: an investment in such a venture incurs both out-of-state taxes and the Maryland county tax on the same income; a similar venture that does all its business in Maryland incurs only the county tax.

The tax at issue in this case is also similar to the one in Halliburton Oil Well Co. v. Reily. There, a Louisiana statute had the discriminatory effect of imposing a greater tax on goods manufactured outside Louisiana than on goods manufactured within that state, thereby creating an incentive to locate the manufacturing process within Louisiana. Although the mechanism is different, the application of the credit in Maryland's income tax law has a similar discriminatory effect. The more a Maryland business can locate its value-creating activities within Maryland the less it will be taxed.

Thus, the application of the county tax to pass-through S corporation income sourced in other states that tax that income, without application of an appropriate credit, discriminates against interstate commerce.

Conclusion

For the reasons explained above, the failure of the Maryland income tax law to allow a credit against the county tax for a Maryland resident taxpayer with respect to pass-through income of an S corporation that arises from activities in another state and that is taxed in that state violates the dormant Commerce Clause of the federal Constitution.

As for relief, the Wynnes suggest in their brief that the Maryland county income tax, the credit, or some part of the Maryland tax scheme be “struck down.” In fact, the county income tax itself is not unconstitutional. Nor is the credit, which serves to ensure that the Maryland income tax scheme operates within constitutional constraints. Nor is the Maryland income tax law generally. What is unconstitutional is the application—or lack thereof—of the credit to the county income tax. As this Court explained in some detail in Blanton, a credit previously applied to the county income tax in these circumstances. The county income tax was only eliminated from the computation and application of the credit by a 1975 amendment of the tax code, Chapter 3, Laws of Maryland 1975. It is that amendment, when applied to the particular circumstances of taxpayers like the Wynnes, that contravenes the Constitution. On remand from the Circuit Court, the Tax Court should recalculate the Wynnes' tax liability in a manner consistent with this opinion.
JUDGMENT OF THE CIRCUIT COURT FOR HOWARD COUNTY AFFIRMED WITH DIRECTION TO REMAND TO THE TAX COURT FOR FURTHER PROCEEDINGS CONSISTENT WITH THIS OPINION. COSTS TO BE SHARED EQUALLY BY THE PARTIES.

BATTAGLIA and GREENE, JJ., dissent.

GREENE, J., dissenting, in which BATTAGLIA, J., joins.

I disagree with the Majority's conclusion that the federal Constitution's dormant Commerce Clause requires Maryland to reduce the Wynnes' county taxes. Since the early Nineteenth Century, the law has been:

[T]he power of taxation is one of vital importance ... retained by the states.... [T]he power of taxing the people and their property[ ] is essential to the very existence of government, and may be legitimately exercised on the objects to which it is applicable, to the utmost extent to which the government may choose to carry it. The only security against the abuse of this power, is found in the structure of the government itself. In imposing a tax, the legislature acts upon its constituents. This is, in general, a sufficient security against erroneous and oppressive taxation.

The Wynnes may not agree that they should pay the Howard County tax without a credit pursuant to TG § 10–703. This, however, is an issue for the elected officials of Howard County and the State, not this Court. “It is not a purpose of the Commerce Clause to protect state residents from their own state taxes.” The Maryland General Assembly's decision to apply a credit for taxes paid in other states to the Wynnes' state tax, and not their county tax, does not run afoul of the federal Constitution's dormant Commerce Clause.

The Wynnes live in Howard County where they benefit from the services provided by that county. To pay for these services, Howard County, like every county in Maryland, including Baltimore City, assesses a tax. As the Majority notes, TG § 10–703 does not permit the Wynnes to apply a credit for taxes paid in other states to reduce the Howard County tax. Rather, as we said in Comptroller v. Blanton, residents of a Maryland county are required to pay for that county's services by paying the county tax without the credit. Otherwise, “if the taxpayers were allowed to pay a lesser amount of county income tax, it ‘would have the possible absurd result of the [taxpayers] paying little or no local tax for services provided by the county while a neighbor with similar income, exemptions, and deductions might be paying a substantial local tax to support those services.’ ”

The Majority acknowledges that Maryland law prohibits the Wynnes from applying a credit for taxes paid to other state to reduce their county taxes. The Majority, however, concludes that imposing a county tax without allowing for a credit pursuant to TG § 10–703 violates the dormant Commerce Clause because Maryland's taxing scheme fails two prongs of the Complete Auto four-part test, namely that it is not fairly apportioned, and it discriminates against interstate commerce. As we have said before, however:
Declaring a statute enacted by the General Assembly to be unconstitutional and therefore unenforceable is an extraordinary act. Statutes are generally presumed to be Constitutional and are not to be held otherwise unless the Constitutional impediment is clear. We have said many times that since every presumption favors the validity of a statute, it cannot be stricken down as void, unless it plainly contravenes a provision of the Constitution.

Because of this presumption, a heavy burden is on the Wynnes to prove that this Court should not enforce Maryland law as it is written.

The Majority states that before this Court can decide whether the dormant Commerce Clause has been violated, we must “assess first whether the dormant Commerce Clause is implicated by the county tax....” Contrary to the Majority's conclusion, however, it appears that the Wynnes have failed to meet their burden of showing that the dormant Commerce Clause is implicated.

States have the power to impose taxes that may result in some overlap in taxation of income. As the Majority notes, “[T]he dormant Commerce Clause will not affect the application of a tax unless there is actual or perspective competition between entities in an identifiable market and state action that either expressly discriminates against or places an undue burden on interstate commerce. This impact must be more than incidental.” In the present case, the Wynnes have failed to prove that requiring them to pay a county tax without a credit either expressly discriminates against interstate commerce or places more than an incidental burden upon interstate commerce. Therefore, the Wynnes have failed to prove that the dormant Commerce Clause is implicated.

The Howard County tax, assessed without a credit, does not expressly discriminate against interstate commerce. As the Comptroller argues, the Howard County tax is directed at income earned by residents of Howard County, not interstate commerce. And while, as the Majority notes, the dormant Commerce Clause “is not limited to circumstances where physical goods enter the stream of commerce[,]” the other cases the Majority relies on all involve situations where, unlike the present case, the law was facially discriminatory. The Majority looks to Camps Newfound/Owatonna v. Town of Harrison, Edwards v. California, Boston Stock Exchange v. State Tax Comm'n, and Fulton Corp. v. Faulkner to conclude that the dormant Commerce Clause is implicated. In all four of those cases, the challenged tax law facially discriminated against interstate commerce by either first distinguishing between organizations and businesses that were involved in interstate business and those organizations and businesses that were only involved with intrastate business, and then imposing a disadvantage upon those involved in interstate transactions, or, in the case of Edwards, placing a restriction upon people moving in interstate commerce itself.

In Camps Newfound/Owatonna, the challenged Maine tax law granted a general exemption from real estate and personal property taxes for charities incorporated in Maine, but limited that exemption for
organizations that mostly served non-Maine residents. The law, thereby, distinguished between groups that served people traveling in interstate commerce and those that only served Maine residents and explicitly benefitted the latter. In Edwards, the challenged law directly implicated interstate commerce and travel by prohibiting the transportation of indigent persons across state lines. In Boston Stock Exchange, the challenged New York tax law distinguished between sales of securities made within New York and those made outside New York, and then imposed a lower tax rate and a cap on taxes for in-state sales and a higher tax rate and no cap on taxes for out-of-state sales. Finally, in Fulton Corp., North Carolina imposed a tax on investments in corporations but allowed stockholders to reduce their tax liability based on the business the corporation did in North Carolina. In Fulton Corp., the United States Supreme Court noted that the tax facially discriminated against interstate commerce, and North Carolina “practically concede[d] as much.”

In the present case, nothing on the face of the Maryland tax laws imposing a county tax, TG § 10–103, or the Maryland tax law limiting credits for taxes paid in other states to state taxes, TG § 10–703, discriminates against interstate commerce. TG § 10–103 imposes a county tax on all residents with no distinction drawn based upon the source of the income. And, TG § 10–703, on its face, provides a benefit to interstate commerce by applying a credit to reduce the amount of Maryland state taxes paid by residents who earned income in interstate commerce. The only distinction drawn between income earned in intrastate commerce and income earned in interstate commerce pursuant to these two laws is that a benefit is bestowed upon interstate commerce through the credit that is applied to state taxes. This can hardly be interpreted as discriminating against interstate commerce on the face of the law.

The fact that Maryland's tax scheme is not facially discriminatory is critical to the dormant Commerce Clause analysis. As the Majority notes, “[f]acially discriminatory state taxes are subject to the strictest scrutiny, and the ‘burden of justification is so heavy that “facial discrimination by itself may be a fatal defect.” ’ ” In other words, when a court is examining a law that, on its face, draws a distinction between interstate and intrastate commerce and imposes a disadvantage to the former, the burden of proving that the law expressly discriminates against interstate commerce and that the dormant Commerce Clause is implicated is met. In this case, there is no facial discrimination against interstate commerce, and thus, the burden of proving that the dormant Commerce Clause is implicated requires a higher level of proof.

As noted above, the Wynnes have the burden of proving that interstate commerce is implicated. The Wynnes, however, fail to meet this burden with the arguments they present. In arguing that the dormant Commerce Clause is implicated, the Wynnes primarily rely on two lines of arguments, both of which are inapplicable to the present case.

First, the Wynnes rely on our decision in Frey where we concluded that the
“Special Nonresident Tax,” or SNRT, implicated the dormant Commerce Clause. The SNRT is applied to nonresidents doing business in Maryland. On its face, the SNRT singles out income from interstate commerce and applies a tax on that income. It is thus a “facially discriminatory state tax[,]” and subject to “the strictest scrutiny[.]” The county tax, on the other hand, draws no distinction between income earned in interstate and intrastate commerce and is not facially discriminatory. Therefore, unlike the SNRT, the county tax does not expressly discriminate against interstate commerce and our conclusion in Frey that the SNRT implicated the dormant Commerce Clause is inapplicable to the present case.

Second, the Wynnes rely on Camps Newfound/Owatonna, Fulton Corp., and a case from the Minnesota Supreme Court, Chapman v. Comm'r of Revenue. As noted above, Camps Newfound/Owatonna and Fulton Corp. address facially discriminatory laws. Likewise, Chapman addresses a facially discriminatory law. The law in question allowed Minnesota taxpayers to take a tax deduction for contributions to charities “located in and carrying on substantially all of its activities within [Minnesota],” but did not allow a tax deduction for contributions to non-Minnesota charities. The Minnesota Supreme Court stated that “[o]n its face, the statute treats contributions to in-state charitable organizations differently from contributions to out-of-state charitable organizations,” and concluded that it was “facially discriminatory.” As noted above, a law that facially discriminates against interstate commerce necessarily implicates the dormant Commerce Clause. Maryland's tax scheme, which is not facially discriminatory, however, does not necessarily implicate the dormant Commerce Clause. Therefore, like Camps Newfound/Owatonna and Fulton Corp., the conclusion that the law in Chapman implicated the dormant Commerce Clause is inapplicable to the present case.

In the absence of facial or express discrimination, an undue burden on interstate commerce must be shown. In Amerada Hess Corp. v. Dir., Div. of Taxation, New Jersey, the Supreme Court, in considering New Jersey’s denial of a state tax deduction for federal windfall profit tax payments, observed that “in the absence of discriminatory intent or a statute directed specifically at economic activity that occurs only in a particular location ... a deduction denial does not unduly burden interstate commerce just because the deduction denied relates to an economic activity performed outside the taxing State.” The Wynnes, in failing to prove discriminatory intent or unacceptable statutory geographical specificity, have demonstrated neither an undue burden on interstate commerce nor an implication of the dormant Commerce Clause.

The Blanton decision conclusively established that Maryland law applies TG § 10–703's tax credit only to state taxes, not county taxes. The Wynnes asked this Court to conclude that settled Maryland law is unconstitutional under the dormant Commerce Clause. The presumption has always been that Maryland law is
constitutional, and the Wynnes, as challengers of the Maryland tax law, have failed to overcome that presumption by proving that Maryland's tax scheme expressly discriminates against or unduly burdens interstate commerce such that the dormant Commerce Clause is implicated. The Wynnes may believe that it is bad policy to require them to pay the Howard County tax without a tax credit; however, they have failed to prove that it is in violation of the dormant Commerce Clause. Accordingly, I respectfully dissent.

Judge BATTAGLIA joins in the views expressed herein.

Opinion on Motion for Reconsideration by McDonald, J.

The Comptroller has filed a Motion for Reconsideration and, Alternatively, a Motion for Stay of Enforcement of the Judgment. The Wynnes opposed that motion. The parties filed memoranda of law and other materials in support of their respective positions.

It appears appropriate to clarify two points raised in the papers submitted by the parties:

(1) The Comptroller raised the question of whether he could deny application of a credit to the Wynnes for income taxes paid by an S corporation, such as Maxim, in another state that does not accord pass-through treatment to S corporation income, but rather taxes the income of such a corporation in the same way that it taxes the income of a C corporation. The parties did not brief, and we did not consider, the ways in which other states may treat S corporation income other than as pass-through personal income of the corporation's shareholders. Our opinion does not foreclose different treatment in Maryland of income taxes paid in other states that are not based on pass through personal income.

(2) A state may avoid discrimination against interstate commerce by providing a tax credit, or some other method of apportionment, to avoid discriminating against interstate commerce in violation of the dormant Commerce Clause. The Comptroller interprets a footnote in our earlier opinion to hold that a state must provide a tax credit. While the footnote might have been worded more elegantly, it referred primarily to the method used by the Legislature in the Maryland income tax; we did not mean to preclude other methods that might be utilized in other contexts.

The Motion for Reconsideration is DENIED; however, we shall STAY the effective date of the mandate pending the disposition of a timely petition for certiorari filed by the Comptroller with the United States Supreme Court.
“Supreme Court Agrees to Hear Landmark Case on Whether States May Tax Income Earned in Other States”

*Forbes*
Kelly Phillips Erb
May 28, 2014

The Supreme Court had a busy day on Tuesday. When the dust settled, however, it had only granted one new case – but it was a big one. The nation’s highest court granted certiorari to *Comptroller v. Wynne*, setting the stage for a fight that could rewrite tax laws in states across the country.

As noted before, lawyers and judges like to use Latin. Granting certiorari (or “granting cert” for the really cool hipster lawyers) means that the Supreme Court will hear the matter.

Some cases have what’s called “original jurisdiction” in the Supreme Court; those cases, which are defined by statute (28 U.S.C. § 1251) go straight to the Supreme Court. The typical case associated with original jurisdiction would be a dispute between the states. Most cases, however, don’t go that route. To be heard at the Supreme Court level without having original jurisdiction requires the losing party at the appellate level to file a petition seeking a review of the case. If the Supreme Court grants the petition and decides to hear the matter, it’s called a *writ of certiorari*. And that’s what happened here.

The question presented in the Petition for Certiorari in *Wynne* is:

**Does the United States Constitution prohibit a state from taxing all the income of its residents — wherever earned — by mandating a credit for taxes paid on income earned in other states?**

Procedurally, the question found its way to the Supreme Court after the Court of Appeals of Maryland “reached the unprecedented conclusion” that a state is in violation of the Commerce Clause in the U.S. Constitution if it collects income taxes from its residents when the income was earned from sources in another state and is subject to tax by the other state.

In this case, a married couple, the Wynnes, reported taxable net income of approximately $2.7 million. More than half of that amount represented a share of earnings in an S corporation with operations in several states. The Wynnes claimed a credit on their Maryland tax returns for taxes paid to 39 other states but not for any county or local government taxes. The State of Maryland denied the credits and issued a notice of deficiency and the Wynnes appealed. At a hearing, the assessment was affirmed.

Eventually, the Wynnes amended their petition to claim that the tax credit statute was in violation of the Commerce Clause of the United State Constitution. That claim was rejected. At appeal, the Wynnes argued that the state of Maryland was constitutionally required to extend the credit for taxes paid to other states to the county as
well as the state, raising the question of whether a state had the unconditional right to tax all income based on residency. The Circuit Court agreed with the Wynnes.

On appeal by the state, the Court of Appeals agreed with the Circuit Court. The Court wrote that, based on its belief that the Constitution prohibits “double taxation” of income earned in interstate commerce, a state may not tax all the income of its residents, wherever earned.

That decision, it was argued by the state, conflicted with a number of “fundamental precepts” involving the “well-established principle” that “a jurisdiction… may tax all the income of its residents, even income earned outside the taxing jurisdiction.” However, in Wynne, the Court of Appeals concluded that the Commerce Clause imposes restrictions on a state’s power to tax its own residents: in other words, Maryland was not allowed to tax all of its residents’ income if the resident paid taxes on that income to another State.

The state argued that this finding was inconsistent with prior law and was, in a word, wrong. The consequences, according to the state’s petition, could be the “significant loss of revenue that will amount to tens of millions of dollars annually.”

And that’s why you should care. Not only does this decision have consequences for Maryland but it “has potential repercussions beyond Maryland,” according to the petitioner. The reply brief for the petitioner specifically notes that “while most states provide full credits for income taxes paid to other states, many local jurisdictions do not.” The result, if the Wynne decision holds, according to the state is that “any jurisdiction taxing its residents’ entire income will face needless uncertainty about the viability of its tax system and its potential exposure to onerous refund claims.”

In other words, an affirmation could cost local and state governments millions of dollars.

The loss shouldn’t matter, according to Dominic Perella, a lawyer with Hogan Lovells who is representing the Wynnes. He said, about the case: “Maryland’s approach is unfair to people who make money in more than one state.”

The question is big enough for the feds to weigh in. The Obama administration issued an amicus curiae brief in April of this year, supporting the petitioner’s position. Amicus curiae is Latin (yes, more Latin) for “friend of the court” and describes an argument made by someone who is not a specific party to the proceedings but believes that the court’s decision may affect its interest. Under the Rules of the Supreme Court of the U.S., “An amicus curiae brief that brings to the attention of the Court relevant matter not already brought to its attention by the parties may be of considerable help to the Court. An amicus curiae brief that does not serve this purpose burdens the Court, and its filing is not favored.”

The feds argued in their brief that “though States often choose to grant tax credits to their residents for income taxes paid in other States, nothing in the Commerce Clause compels a State to offer such credits or
otherwise defer to other States in the taxation of its own residents’ income.” Further, “[t]he decision… may lead to challenges to similar tax schemes in other jurisdictions; and is inconsistent with statements made by the highest courts in other States.”

The U.S. Supreme Court clearly agreed that this was a matter that needed to be resolved. Granting *cert* doesn’t mean that the court believes that the petitioner is correct: the regular court rules apply. There will be arguments and more (!) briefs before the Court reaches a decision.

These matters do not move quickly: you shouldn’t expect oral arguments on this matter until fall of this year. But expect plenty of speculation – and interest – before then.
The U.S. Supreme Court has announced that it will hear the appeal in *Comptroller v. Wynne*, on whether states must provide a credit against its own taxes for taxes a resident pays to another state. Maryland allows such a credit against its state income tax but not against its local county and city income taxes.

The taxpayers in the case, Mr. and Mrs. Wynne, owned 2.4 percent of a company doing business in 39 states. Maryland residents, they paid $123,434 in income tax to Maryland, after applying a credit of $84,550 for taxes paid to other states on income earned outside Maryland's borders. Maryland disallowed the credit to the extent that it offset the county income tax. The Tax Court upheld the assessment, a Maryland circuit court reversed and sided with the Wynnes, and Maryland's highest court (the Court of Appeals) agreed, ruling the tax unconstitutional without a credit. The state has now appealed to the Supreme Court.

It's hard to think of a more blatant example of impermissible state taxation of interstate commerce than Maryland's tax here. Maryland certainly has the authority to tax the Wynnes -- they are Maryland residents -- but gets into constitutional trouble when it asserts the power to tax income earned outside Maryland. Until this case, it has generally been undisputed by scholars that such a tax is only permissible if the state credits the taxpayer for taxes paid to another state. Otherwise, states would be able to subject the same income to double-, triple-, quadruple-, etc. levels of taxation. The net result of this would be to strongly discourage interstate investment and commerce of the type the Wynnes undertook, since only by investing within Maryland would income not be subject to gargantuan levels of taxation.

Analyzing whether Maryland's tax is constitutional is a two-step process. First, one must ask whether the state has the authority to impose the tax on income. This is fairly well-settled, with the statute authorizing the tax and numerous court precedents allowing states to tax their residents however they wish, with any credits or deductions a matter of legislative grace. Second, though, one must ask whether the tax discriminates against interstate commerce. This has been sometimes described as an "internal consistency test" -- if every state had such a tax, would the result be discrimination against interstate commerce? The answer here is unequivocally yes. The state (and the U.S. Solicitor General, who was asked for his views) performed step one of this analysis but did not do step two. Their arguments would get an F grade in any state taxation class as incomplete.

17 states have local income taxes, and while most provide a credit for taxes paid to another state, they probably do so because
they think they have to, constitutionally. An adverse ruling here will quickly result in taxpayers being taxed on the state income over and over by any state with any tax authority over them. Although this case relates to local income taxes, there is no logical reason why the rule should be different for state income taxes.

It would have been best if the Court declined to hear the case and let the Maryland Court of Appeals ruling stand. As they have now agreed to hear it, the Court should take a strong stand against states using their tax systems to discriminate against interstate commerce. We will make such an argument in our amicus brief. (Both the Maryland Attorney General and Wynne cited our 2011 local income tax study in their briefs to the Court.)

I. Introduction

If a resident individual of State A seeks employment in State B, or owns income-producing property or opens a business in State B, does that individual's status as nonresident, standing alone, constitute interstate commerce subjecting State B's nonresident income tax to the strictest scrutiny under the U.S. Constitution's dormant commerce clause? Or does the privileges and immunities clause of Article IV apply, with its heightened "substantial equality" level of scrutiny?

It is clear that both constitutional provisions cannot apply in that instance. If the mere status of an individual as a nonresident constitutes interstate commerce and invokes the stricter protections of the dormant commerce clause, then the privileges and immunities clause would be eclipsed and effectively nullified in every instance. The substantial equality standard of review would never apply when the issue involves discrimination against nonresident individuals.

Under basic principles of legal construction, express language generally controls over language that is implied. The dormant commerce clause is not an express constitutional provision, but has been implied as a means of delineating the federal and state powers to regulate interstate commerce. The dormant commerce clause, therefore, shouldn't be construed so broadly as to nullify the privileges and immunities clause, an express constitutional provision long construed to protect nonresident individuals.

Also, do the two constitutional provisions really cover the same subjects? Does the scope of the dormant commerce clause, which protects an interstate business in its choice of where to locate its business operations, also extend to the personal choices of nonresident individuals who choose to work, or otherwise earn their income, in a state different from where they live?

It is well established that the dormant commerce clause protects from discrimination interstate business transactions and business location decisions, that is, "a State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." By contrast, an individual's choice of where to live is a personal decision. Federal income tax rules, for instance, treat the cost of commuting from home to work as a personal and not a deductible business expense.

Thus, while the decision to locate manufacturing operations in one state instead of another is protected by the dormant commerce clause, the privileges
and immunities clause of Article IV protects nonresident individuals from discrimination, that is, the personal choice to live in one state and work in another.

In *Maryland v. Wynne*, the Maryland Court of Appeals held that when an individual, a resident of Maryland, earns income in other states, the mere status of being a nonresident in those other states, within the jurisdiction of those other states' nonresident income tax laws, constitutes interstate commerce, implicating the dormant commerce clause. Although *Wynne* concerned the taxpayer's investment in an S corporation, its reasoning extends to all income within the scope of a nonresident income tax, including wages and salaries earned in the course of commuting from home to work.

On May 27 the U.S. Supreme Court granted the state's petition for writ of certiorari. If the Court upholds *Wynne*, it will essentially nullify the privileges and immunities clause of Article IV. Every discrimination claim based on nonresidency will be easily restated as a dormant commerce clause claim. States will have far less latitude in structuring their personal income tax laws, which will no longer be subject to the substantial equality standard, but to the strictest scrutiny. The federal-state balance will significantly change.

Although the issue in *Wynne* concerns tax credits, it has far broader implications. Most states grant their residents personal income tax credits for other states' nonresident income taxes. They do so for political reasons, so their voting residents will not see their incomes and personal wealth diminished by two separate tax jurisdictions with equally defensible claims to that income.

A state's taxing jurisdiction over its residents, based on the special privileges of citizenship, is over the person, and extends to all of the resident's income, regardless of where it is earned. A state's taxing jurisdiction over nonresidents is narrower -- limited to the nonresidents' income-producing activities and property within the state. A resident who earns income in another state that imposes a nonresident income tax will always be taxed twice, by the state of residence and by the state in which the income was earned. Neither state's jurisdictional claim is superior to the other, nor would favoring one state over the other be fair. For example, requiring the state of residence to credit taxes paid to other states would forfeit the state of residence's just claim to that revenue, and would treat the state of residence unfairly.

The due process clause of the 14th Amendment does not bar the double taxation of income. In sum, the dormant commerce clause does not apply here because (1) it would be an unprecedented expansion of its scope, from protecting interstate business transactions and business location decisions, to protecting the personal choices of individuals who earn income in a state different from where they live, and (2) it would completely eclipse the privileges and immunities clause of Article IV, rendering it a nullity, and change the federal-state balance in favor of lessening the states' power to tax nonresidents.

**II. The Facts of Wynne**
The Wynnes were 2.4 percent shareholders in a corporation, Maxim Healthcare Services Inc., which was engaged in a multistate healthcare business. Maxim made an election under the Internal Revenue Code to be taxed as an S corporation. As a result, Maxim paid no federal income tax, and its income was passed through to its shareholders and subject to federal income tax at the shareholder level.

For the 2006 tax year, Maxim filed state corporate income tax returns in 39 states, and it allocated to each shareholder a pro rata share of the taxes paid to each of those states. The Wynnes claimed their pro rata share of Maxim's corporate income taxes paid to other states as a credit against their Maryland resident state and county income taxes. The Maryland comptroller denied the portion of the Wynnes' credit that applied to the resident county income tax. The resulting tax deficiency was affirmed by the Hearings and Appeals Bureau of the Comptroller's Office.

The Wynnes appealed to the Maryland Tax Court, where they argued that the failure to grant a credit for income taxes paid to other states against the county income tax discriminated against interstate commerce, in violation of the dormant commerce clause. The tax court rejected that argument and affirmed the assessment. The Wynnes appealed to the circuit court, which reversed the tax court. The case was eventually appealed to the Maryland Court of Appeals.

III. The Maryland Appeals Court Decision

The Wynnes conceded Maryland's jurisdiction, under the due process clause, to tax all of their income, regardless of where it was earned. The sole issue before the Maryland Appeals Court was whether Maryland's failure to grant a tax credit against its county income tax for taxes paid to other states violated the dormant commerce clause.

As an initial matter, the court considered whether the dormant commerce clause applies to individuals who maintain their personal residences in Maryland, but earn income in other states that impose nonresident income taxes. The comptroller argued that the Wynnes were subject to the Maryland income tax on individuals because of their status as Maryland residents, and not because of their activities in Maryland or in other states.

The court rejected that argument, holding that the Wynnes were subject to the Maryland income tax both because they were Maryland residents and "because they have income derived from intrastate and interstate activities." Because of their interstate activities, "other states may also tax some of that income because it derives from activities in those states." However, it is well established that a state's power to tax persons residing within the state is based solely on their status as citizens or residents and is without regard to their activities or to the source of their income.

The Maryland court thus mischaracterized the Maryland resident income tax on individuals as a tax on the individual's activities. To the contrary, Maryland's taxing power over persons residing within its
jurisdiction is based only on their residency status. When Maryland taxes its residents, it is taxing them in their person, not their activities, whether conducted out-of-state or otherwise. If not for the Wynnes' status as residents, Maryland would be powerless to tax them on their out-of-state activities, which would be outside of Maryland's taxing jurisdiction. To the extent that the Maryland court's reasoning depended on its characterization of the resident income tax as a tax on interstate activities, its conclusion that the resident tax implicates interstate commerce was erroneous.

If Maryland isn't taxing activities in other states, but merely the persons within its power, it is difficult to see how the resident income tax implicates interstate commerce. In concluding that it does, the Maryland court compared a Maryland resident "who earns substantial income from out-of-state activities" with "an otherwise identical taxpayer" who earns all of his income in Maryland. The court explained that "the first taxpayer may pay more state and local income taxes than the second. That creates a disincentive for the taxpayer -- or the S Corporation of which the taxpayer is an owner -- to conduct income-generating activities in other states with income taxes."

The Maryland Court of Appeals makes several assumptions here that are speculative at best and that raise several concerns. In comparing a Maryland resident individual who earns substantial income from out of state with an identical taxpayer who earns income entirely from Maryland activities, even the court realizes, by its use of the word "may," that the first taxpayer will not necessarily pay more in state and local taxes than the second taxpayer. Not every state imposes a personal income tax. Thus, if the first taxpayer earns substantial income in a state that does not impose a nonresident income tax, then it will pay the same amount of state and local taxes as the taxpayer who earns income entirely from Maryland activities.

While the factual basis for that comparison is speculative, it raises a greater concern -- the comparison between the two hypothetical taxpayers residing in Maryland depends entirely on another state's tax law, which is beyond the control of the Maryland General Assembly and in which Maryland has no sovereign interest. The U.S. Supreme Court has made it clear that the constitutionality of one state's tax laws can never depend on the tax laws in other states. If Maryland has full jurisdiction to tax its individual residents in their person on all of their income, regardless of where it was earned, does Maryland have to forfeit that power to another state having an equally founded jurisdiction over their activities, if that state imposes a nonresident income tax?

Under the court's reasoning, the state of residency and the source state would not be treated as coequal sovereigns, elevating the power of the source state to the detriment of the state of residency. Moreover, the tax laws of the state of residency would be dependent on the tax laws of the source state. The state of residency would forfeit its taxing power if that other state's legislature enacts a nonresident income tax.
IV. The Maryland Resident Income Tax Credit Doesn't Affect Interstate Commerce

In concluding that Maryland's resident income tax creates a disincentive for the taxpayer to conduct income-generating activities in other states with income taxes, the Maryland court relied on *Fulton Corp. v. Faulkner*. *Fulton* involved a credit under North Carolina's intangibles property tax that decreased as the stock issuer did a greater proportion of its business outside the state. The *Fulton* Court held that "the intangibles tax facially discriminates against interstate commerce" because a "regime that taxes stock only to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents and tends, at least, to discourage domestic corporations from plying their trades in interstate commerce."

The tax credit in *Fulton* operated as a classic tariff, benefitting corporate stock issuers that do most of their business within North Carolina by burdening issuers that do most of their business outside of the state. The Maryland court erred by comparing Maryland's individual income tax on residents to the intangibles tax in *Fulton*. Unlike the intangibles tax credit, which decreased as the issuer corporation expanded its business in interstate commerce, the resident income tax remains the same, regardless of whether a Maryland resident earns $100,000 of income in Maryland or the same amount of income in another state.

In order to conclude that a Maryland resident pays a higher tax if it earns income in another state, the Maryland court had to look past the Maryland resident income tax to the nonresident income tax imposed by another jurisdiction. Again, the constitutionality of Maryland's tax laws can't depend on the tax laws of other states.

Unlike the intangibles tax in *Fulton*, the Maryland resident income tax doesn't create a disincentive for the taxpayer to conduct income-generating activities in other states. The result in *Fulton* didn't depend on the tax laws in effect in other states, but only on the discriminatory effect of North Carolina's intangibles tax standing alone. Standing alone, Maryland's resident income tax doesn't affect interstate commerce. The court's contrary conclusion was based on a reading of the dormant commerce clause long rejected by the U.S. Supreme Court.

V. The Maryland Resident Income Tax Doesn't Affect Interstate Travel

A Maryland resident who travels to another state to earn income pays the same amount of Maryland resident income tax as a Maryland resident who earns all of his income in Maryland. Notwithstanding the Maryland court's contrary conclusion, Maryland's resident income tax, standing alone, doesn't implicate "the movement of people across state borders for economic purposes."

The court of appeals appears to have read *Camps Newfound v. Town of Harrison* as a case that applies the dormant commerce clause to individuals who travel or commute across state lines to earn income in another
state. *Camps Newfound*, however, wasn't a right of travel case but concerned an export tariff on services. In *Camps Newfound*, Maine's real property tax exemption for charitable organizations was limited to charities that principally served Maine residents. The taxpayer, a Christian Science summer camp that aggressively marketed its picturesque Maine facilities around the country, generated 95 percent of its business from campers residing in other states. Because the camp mainly served nonresidents, Maine denied the camp's property tax exemption.

The U.S. Supreme Court invalidated Maine's property tax exemption on the grounds that "it functionally serves as an export tariff that targets out-of-state consumers by taxing the businesses that principally serve them." The camp had aggressively reached out to consumers in other states, from which it received practically all of its campers; the discriminatory exemption had the practical effect of an export tariff on services, sharing the same fate as an export tariff on goods.

In concluding that *Camps Newfound* is a right of travel case, the Maryland Court of Appeals apparently focused on a single sentence responding to an argument made by the town of Harrison that the property tax exemption does not affect interstate commerce. Referring to the nonresident campers who attended the camp, the U.S. Supreme Court observed that "[t]he attendance of these campers necessarily generates the transportation of persons across state lines that has long been recognized as a form of 'commerce.'"

*Camps Newfound*, however, does not hold that Maine's property tax exemption interfered with the campers' right to freely enter and leave the state, burdening the campers' right of travel. That wasn't the issue before the Court. The Court concluded that Maine's property tax exemption was functionally equivalent to an "export tariff" and that its practical effect was to discriminate against the interstate sale of camp services to nonresident consumers. The Court's reference to the interstate travel of the campers was one of several facts identified by the Court to underscore the interstate nature of the transactions burdened by the exemption.

The Maryland court's reading of *Camps Newfound* as a right of travel case conflicts with U.S. Supreme Court precedent holding that the right isn't protected by the dormant commerce clause. In *Bray v. Alexandria Women's Health Clinic*, the Court held that the individual right of interstate travel "does not derive from the negative commerce clause, or else it could be eliminated by Congress."

*Saenz v. Roe* divided the right of travel into three components: (1) the right to enter and leave the state; (2) the right of a citizen of one state who travels to another state intending to return home, to enjoy the same "Privileges and Immunities of the Citizens of the several States" that she visits; and (3) when the traveler doesn't intend to return home, the right to be treated like other citizens of that state.

It is the second component of the right of travel that is at issue in *Wynne*. *Saenz* stated that right isn't subject to the strict scrutiny of
the dormant commerce clause, but to the lesser substantial equality standard under the privileges and immunities clause.

The Maryland court, therefore, was incorrect in holding that the fact that an individual resident of one state earns income in another state that imposes a nonresident income tax implicates the dormant commerce clause. Rather, the privileges and immunities clause protects from discrimination nonresident individuals who seek employment or otherwise seek to earn income in another state. The court's holding to the contrary is an unwarranted expansion of the dormant commerce clause beyond its present scope, which changes the federal-state balance under our system of federalism to the detriment of the states, subjecting state individual income tax laws to the strictest scrutiny, while lessening the states' authority to tax nonresident individuals.

VI. Distinguishing Commercial Domicile From Individual Residency

Under the unitary business principle, a state may not tax a corporation engaged in a multistate business on 100 percent of the corporation's income. The requirement that a state must apportion the income of a corporation derived from business conducted in other states is grounded in both the due process and commerce clauses of the U.S. Constitution.

Although the commerce clause plays a role in apportionment, limiting multiple taxation by requiring a state's apportionment formula to be internally consistent, it is plain that the constitutional restrictions on apportionability are almost entirely described in due process terms. In formulary apportionment cases, the commerce clause generally plays a secondary role to due process, in the sense that a formula that taxes extraterritorial values and thus violates due process, also results in multiple taxation violating the commerce clause.

In limited circumstances, a corporation's state of commercial domicile may tax the corporation on 100 percent of its income, but only if that income was earned in activities unrelated to its unitary business. Otherwise, the income of a multistate corporation derived from a unitary business must be apportioned "on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction."

It might be tempting to extend the limitation on a state's power to tax corporate income to the personal income tax, thus prohibiting states from taxing the income of individuals who reside there but earn their living in another state. Proponents of this approach believe it is consistent with the dormant commerce clause. This reading of the clause requires that when two states have jurisdiction to tax an individual, the state of residence over the person and another state over the individual's activities, the state having jurisdiction over the activities should take precedence.

The rationale for requiring the state where an individual resides to yield its taxing power to the state where the individual earns his income appears to be based on three assumptions: (1) that there is no reason to treat the taxation of individuals based on
personal residence differently from the taxation of corporations based on commercial domicile; (2) that individuals who work or otherwise earn income in other states acquire the equivalent of a business situs there, which should prevail in any conflict with the individual's domicile; and (3) although the due process clause doesn't prohibit the double taxation of income, the requirement that a multistate corporation apportion its income to other states is dictated by the commerce clause. I will consider each in turn.

The notion that a corporation is a person capable of acquiring a domicile within a particular state is a legal fiction that is given relatively little weight under the corporate income tax, generally yielding to the state in which the income is earned under the unitary business principle. Consistent with that legal fiction is the reality that a corporation is, in every respect, a business and no aspect of its legal existence can be deemed personal.

Individuals, on the other hand, are real persons. When a state exercises its jurisdiction to tax individuals who maintain their homes within the state, send their children to schools, and receive the benefits of "police and fire protection . . . and the advantages of living in a civilized society," the state justifiably calls on those individuals in their strictly personal aspect to share the cost of providing those services. If those individuals happen to commute to work in other states, which also have a just claim to tax a portion of their income, that should not relieve those individuals of their obligation to pay for all of the many services they receive as citizens and residents of their home state.

As explained above, extending the dormant commerce clause to the individual income tax would completely eclipse the privileges and immunities clause of Article IV and render it a nullity. That issue does not arise in the area of corporate income taxation because the privileges and immunities clause does not apply to corporations, which are not citizens.

The legal fiction that a corporation is a person capable of having a domicile within a state derives from the property tax. Under the doctrine *mobilia sequuntur personam*, intangible property is assigned a situs at the place of the owner's domicile under the assumption that the owner controls the property from that location. Nevertheless, once the intangible acquires a business situs in another state, that other state also has jurisdiction to tax the intangible. Invoking the commerce clause, it is argued that the state where the property acquired a business situs has the superior claim.

That may be, but the reasoning doesn't extend to the personal income taxation of individual residents who commute to work, or otherwise earn income, in other states. A state's power to tax an individual citizen or resident in his person isn't a legal fiction but one of three jurisdictional bases for a state to exert its taxing power -- over the persons, property, or activities within its borders. When an individual maintains a home in one state and works in another, the home state retains its power to demand that the individual contribute to the cost of
government, regardless of the source of his income.

As explained above, the requirement that a multistate corporation apportion its income is dictated primarily by the due process clause. That is evident by the "minimal connection" and "rational relationship" language, which is exclusively due process language that appears in every unitary business case. The only additional limitation, derived exclusively from the commerce clause, is the requirement that an apportionment formula be internally consistent to avoid multiple taxation.

The commerce clause does not restrict state apportionment formulas, except to require that they must be internally consistent. The main restriction on state apportionment formulas derives from due process, which requires that the income apportioned to a state must be rationally related to in-state activity. When two states have equal jurisdiction, one over the individual, the other over the individual's activity, the commerce clause does not pose an additional barrier to the home state's jurisdiction over its individual residents. Any other rule would deprive the home state of its ability to call on resident individuals to contribute their fair share to the cost of schools, police and fire protection, sanitation, and other services they benefit from as citizens and residents of their home state.

VII. Conclusion

Wynne represents a significant and unwarranted expansion of the dormant commerce clause. Currently, it protects from discrimination interstate business transactions and business location decisions. Wynne extends this protection to new territory previously the domain of the privileges and immunities clause of Article IV -- protecting the personal choices of individuals who earn income in a state different from where they reside. If the dormant commerce clause is extended to the personal income taxation of resident individuals, it would completely eclipse the privileges and immunities clause of Article IV, render it a nullity, and change the federal-state balance by reducing the states' power to tax nonresidents. It would also deprive the home state of its ability to call on its residents to pay their fair share of the cost of government and for the many services they enjoy as state residents.


**Department of Transportation v. Association of American Railroads**  
13-1080


Railroad association sued the Department of Transportation and others, claiming that a section of the Passenger Railroad Investment and Improvement Act of 2008 (PRIIA) requiring the Federal Railroad Administration (FRA) and a federally chartered corporation providing intercity and commuter train services to “jointly” develop standards to evaluate the performance of the corporation's intercity passenger trains was unconstitutional. The United States District Court for the District of Columbia, James E. Boasberg, J., granted summary judgment for government. Association appealed.

**Question Presented:** Whether Section 207 of the Passenger Rail Investment and Improvement Act of 2008, which requires the Federal Railroad Administration (FRA) and Amtrak to “jointly . . . develop” the metrics and standards for Amtrak’s performance that will be used in part to determine whether the Surface Transportation Board (STB) will investigate a freight railroad for failing to provide the preference for Amtrak’s passenger trains that is required by federal law, and provides for the STB to appoint an arbitrator if the FRA and Amtrak cannot agree on the metrics and standards within 180 days, effects an unconstitutional delegation of legislative power to a private entity.

**ASSOCIATION OF AMERICAN RAILROADS, Appellant**  
v.  
**UNITED STATES DEPARTMENT OF TRANSPORTATION, et al., Appellees**

United States Court of Appeals, District of Columbia Circuit  
Decided on July 2, 2013

[Excerpt, some footnotes and citations omitted]

**BROWN, Circuit Judge:**

Imagine a scenario in which Congress has given to General Motors the power to coauthor, alongside the Department of Transportation, regulations that will govern all automobile manufacturers. And, if the two should happen to disagree on what form those regulations will take, then neither will have the ultimate say. Instead, an unspecified arbitrator will make the call.

Constitutional? The Department of Transportation seems to think so.

Next consider a parallel statutory scheme—the one at issue in this case. This time, instead of General Motors, it is Amtrak (officially, the “National Railroad Passenger Corporation”) wielding joint regulatory power with a government agency. This new stipulation further complicates the issue. Unlike General Motors, Amtrak is a curious
entity that occupies the twilight between the public and private sectors. And the regulations it codevelops govern not the automotive industry, but the priority freight railroads must give Amtrak's trains over their own. Whether the Constitution permits Congress to delegate such joint regulatory authority to Amtrak is the question that confronts us now.

Section 207 of the Passenger Rail Investment and Improvement Act of 2008 empowers Amtrak and the Federal Railroad Administration (FRA) to jointly develop performance measures to enhance enforcement of the statutory priority Amtrak's passenger rail service has over other trains. The Appellant in this case, the Association of American Railroads (AAR), is a trade association whose members include the largest freight railroads (known in the industry as “Class I” freight railroads), some smaller freight railroads, and—as it happens—Amtrak. Challenging the statutory scheme as unconstitutional, AAR brought suit on behalf of its Class I members against the four Appellees—the Department of Transportation, its Secretary, the FRA, and its Administrator (collectively, the “government”). We conclude § 207 constitutes an unlawful delegation of regulatory power to a private entity.

I

A

To reinvigorate a national passenger rail system that had, by mid-century, grown moribund and unprofitable, Congress passed the Rail Passenger Service Act of 1970. Most prominently, the legislation created the passenger rail corporation now known as Amtrak, which would “employ[ ] innovative operating and marketing concepts so as to fully develop the potential of modern rail service in meeting the Nation's intercity passenger transportation requirements.” The act also made railroad companies languishing under the prior regime an offer they could not refuse: if these companies consented to certain conditions, such as permitting Amtrak to use their tracks and other facilities, they could shed their cumbersome common carrier obligation to offer intercity passenger service. Pursuant to statute, Amtrak negotiates these arrangements with individual railroads, the terms of which are enshrined in Operating Agreements. Today, freight railroads own roughly 97% of the track over which Amtrak runs its passenger service.

Naturally, sharing tracks can cause coordination problems, which is why Congress has prescribed that, absent an emergency, Amtrak's passenger rail “has preference over freight transportation in using a rail line, junction, or crossing.” More recently, this same concern prompted enactment of the Passenger Rail Investment and Improvement Act of 2008 (“PRIIA”). At issue in this case is the PRIIA's § 207, which directs the FRA and Amtrak to “jointly ... develop new or improve existing metrics and minimum standards for measuring the performance and service quality of intercity passenger train operations, including cost recovery, on-time performance and minutes of delay, ridership, on-board services, stations, facilities, equipment, and other services.” If Amtrak and the FRA disagree about the composition of these “metrics and standards,” either
“may petition the Surface Transportation Board to appoint an arbitrator to assist the parties in resolving their disputes through binding arbitration.” “To the extent practicable,” Amtrak and its host rail carriers must incorporate the metrics and standards into their Operating Agreements.

Though § 207 provides the means for devising the metrics and standards, § 213 is the enforcement mechanism. If the “on-time performance” or “service quality” of any intercity passenger train proves inadequate under the metrics and standards for two consecutive quarters, the STB may launch an investigation “to determine whether and to what extent delays or failure to achieve minimum standards are due to causes that could reasonably be addressed by a rail carrier over whose tracks the intercity passenger train operates or reasonably addressed by Amtrak or other intercity passenger rail operators.” Similarly, if “Amtrak, an intercity passenger rail operator, a host freight railroad over which Amtrak operates, or an entity for which Amtrak operates intercity passenger rail service” files a complaint, the STB “shall" initiate such an investigation. Should the STB determine the failure to satisfy the metrics and standards is “attributable to a rail carrier's failure to provide preference to Amtrak over freight transportation as required,” it may award damages or other relief against the offending host rail carrier.

B

Following § 207's mandate, the FRA and Amtrak jointly drafted proposed metrics and standards, which they submitted to public comment on March 13, 2009. The proposal attracted criticism, with much vitriol directed at three metrics formulated to measure on-time performance: “effective speed” (the ratio of route's distance to the average time required to travel it), “endpoint on-time performance” (the portion of a route's trains that arrive on schedule), and “all-stations on-time performance” (the degree to which trains arrive on time at each station along the route). AAR, among others, derided these metrics as “unrealistic” and worried that certain aspects would create “an excessive administrative and financial burden.” The FRA responded to the comments, and a final version of the metrics and standards took effect in May 2010.

AAR filed suit on behalf of its Class I freight railroad members, asking the district court to declare § 207 of the PRIIA unconstitutional and to vacate the promulgated metrics and standards. The complaint asserted two challenges: that § 207 unconstitutionally delegates to Amtrak the authority to regulate other private entities; and that empowering Amtrak to regulate its competitors violates the Fifth Amendment's Due Process Clause. The district court rejected these arguments, granting summary judgment to the government and denying it to AAR. AAR renews these constitutional claims on appeal.

II

AAR's argument takes the following form: Delegating regulatory authority to a private entity is unconstitutional. Amtrak is a private entity. Ergo, § 207 is unconstitutional. This proposed syllogism is
susceptible, however, to attacks on both its validity and soundness. In other words, does the conclusion actually follow from the premises? And, if it does, are both premises true? Our discussion follows the same path.

A

We open our discussion with a principle upon which both sides agree: Federal lawmakers cannot delegate regulatory authority to a private entity. To do so would be “legislative delegation in its most obnoxious form.” This constitutional prohibition is the lesser-known cousin of the doctrine that Congress cannot delegate its legislative function to an agency of the Executive Branch. This latter proposition finds scarce practical application, however, because “no statute can be entirely precise,” meaning “some judgments, even some judgments involving policy considerations, must be left to the officers executing the law and to the judges applying it.” All that is required then to legitimate a delegation to a government agency is for Congress to prescribe an intelligible principle governing the statute's enforcement.

Not so, however, in the case of private entities to whom the Constitution commits no executive power. Although objections to delegations are “typically presented in the context of a transfer of legislative authority from the Congress to agencies,” we have reaffirmed that “the difficulties sparked by such allocations are even more prevalent in the context of agency delegations to private individuals.” Even an intelligible principle cannot rescue a statute empowering private parties to wield regulatory authority. Such entities may, however, help a government agency make its regulatory decisions, for “[t]he Constitution has never been regarded as denying to the Congress the necessary resources of flexibility and practicality” that such schemes facilitate. Yet precisely how much involvement may a private entity have in the administrative process before its advisory role trespasses into an unconstitutional delegation? Discerning that line is the task at hand.

Preliminarily, we note the Supreme Court has never approved a regulatory scheme that so drastically empowers a private entity in the way § 207 empowers Amtrak. True, § 207 has a passing resemblance to the humbler statutory frameworks in *Currin v. Wallace* and *Sunshine Anthracite Coal Co. v. Adkins*. In *Currin* Congress circumscribed its delegations of administrative authority—in that case, by requiring two thirds of regulated industry members to approve an agency's new regulations before they took effect. *Adkins*, meanwhile, affirmed a modest principle: Congress may formalize the role of private parties in proposing regulations so long as that role is merely “as an aid” to a government agency that retains the discretion to “approve [ ], disapprove[ ], or modif[y]” them. Like the private parties in *Currin*, Amtrak has an effective veto over regulations developed by the FRA. And like those in *Adkins*, Amtrak has a role in filling the content of regulations. But the similarities end there. The industries in *Currin* did not craft the regulations, while *Adkins* involved no private check on an agency's regulatory authority. Even more damningly, the agency in *Adkins* could unilaterally change regulations proposed to it by private parties, whereas Amtrak enjoys
authority equal to the FRA. Should the FRA prefer an alternative to Amtrak's proposed metrics and standards, § 207 leaves it impotent to choose its version without Amtrak's permission. No case prefigures the unprecedented regulatory powers delegated to Amtrak.

The government also points out that the metrics and standards themselves impose no liability. Rather, they define the circumstances in which the STB will investigate whether infractions are attributable to a freight railroad's failure to meet its preexisting statutory obligation to accord preference to Amtrak's trains. We are not entirely certain what to make of this argument. Taken to its logical extreme, it would preclude all preenforcement review of agency rulemaking, so it is probably unlikely the government is pressing so immodest a claim. If the point is merely that the STB adds another layer of government “oversight” to Amtrak's exercise of regulatory power, this precaution does not alter the analysis. Government enforcement power did not save the rulemaking authority of the private coal companies in Carter Coal, nor the power of private landowners in Washington ex rel. Seattle Title Trust Co. v. Roberge to impose a zoning restriction on a neighbor's tract of land. As is often the case in administrative law, the metrics and standards lend definite regulatory force to an otherwise broad statutory mandate. The preference for Amtrak's traffic may predate the PRIIA, but the metrics and standards are what channel its enforcement. Certainly the FRA and Amtrak saw things that way, responding to one public comment by noting the STB “is the primary enforcement body of the standards.” Not only that, § 207 directs “Amtrak and its host carriers” to include the metrics and standards in their Operating Agreements “[t]o the extent practicable.” The STB's involvement is no safe harbor from AAR's constitutional challenge to § 207.

As far as we know, no court has invalidated a scheme like § 207's, but perhaps that is because no parallel exists. Unprecedented constitutional questions, after all, lack clear and controlling precedent. We nevertheless believe Free Enterprise Fund v. Public Co. Accounting Oversight Board offers guidance. There the Supreme Court deemed it a violation of separation of powers to endow inferior officers with two layers of good-cause tenure insulating them from removal by the President. Two principles from that case are particularly resonant. To begin with, just because two structural features raise no constitutional concerns independently does not mean Congress may combine them in a single statute. Free Enterprise Fund deemed invalid a regime blending two limitations on the President's removal power that, taken separately, were unproblematic: the establishment of independent agencies headed by principal officers shielded from dismissal without cause, and the protection of certain inferior officers from removal by principal officers directly accountable to the President. So even if the government is right that § 207 merely synthesizes elements approved by Currin and Adkins, that would be no proof of constitutionality.

As for the second principle, Free Enterprise Fund also clarifies that novelty may, in
certain circumstances, signal unconstitutionality. That double good-cause tenure, for example, lacked an antecedent in the history of the administrative state was one reason to suspect its legality:

“Perhaps the most telling indication of the severe constitutional problem with the PCAOB is the lack of historical precedent for this entity. Neither the majority opinion nor the PCAOB nor the United States as intervenor has located any historical analogues for this novel structure. They have not identified any independent agency other than the PCAOB that is appointed by and removable only for cause by another independent agency.”

In defending § 207, the government revealingly cites no case—nor have we found any—embracing the position that a private entity may jointly exercise regulatory power on equal footing with an administrative agency. This fact is not trivial. Section 207 is as close to the blatantly unconstitutional scheme in *Carter Coal* as we have seen. The government would essentially limit *Carter Coal* to its facts, arguing that “[n]o more is constitutionally required” than the government’s “active oversight, participation, and assent” in its private partner’s rulemaking decisions. This proposition—one we find nowhere in the case law—vitiates the principle that private parties must be limited to an advisory or subordinate role in the regulatory process.

To make matters worse, § 207 fails to meet even the government's ad hoc standard. Consider what would have happened if Amtrak and the FRA could not have reached an agreement on the content of the metrics and standards within 180 days of the PRIIA's enactment. Amtrak could have “petition[ed] the Surface Transportation Board to appoint an arbitrator to assist the parties in resolving their disputes through binding arbitration.” And nothing in the statute precludes the appointment of a private party as arbitrator. That means it would have been entirely possible for metrics and standards to go into effect that had not been assented to by a single representative of the government. Though that did not in fact occur here, § 207’s arbitration provision still polluted the rulemaking process over and above the other defects besetting the statute. As a formal matter, that the recipients of illicitly delegated authority opted not to make use of it is no antidote. It is Congress's decision to delegate that is unconstitutional. As a practical matter, the FRA's failure to reach an agreement with Amtrak would have meant forfeiting regulatory power to an arbitrator the agency would have had no hand in picking. Rather than ensuring Amtrak would “function subordinately” to the FRA, this backdrop stacked the deck in favor of compromise. Even for government agencies, half an apple is better than none at all.

We remain mindful that the Constitution “contemplates that practice will integrate the dispersed powers into a workable government.” But a flexible Constitution must not be so yielding as to become twisted. Unless it can be established that Amtrak is an organ of the government, therefore, § 207 is an unconstitutional delegation of regulatory power to a private party.
Now the crucial question: is Amtrak indeed a private corporation? If not—if it is just one more government agency—then the regulatory power it wields under § 207 is of no constitutional moment.

Many of the details of Amtrak's makeup support the government's position that it is not a private entity of the sort described in *Carter Coal*. Amtrak's Board of Directors includes the Secretary of Transportation (or his designee), seven other presidential appointees, and the President of Amtrak. The President of Amtrak—the one Board member not appointed by the President of the United States—is in turn selected by the eight other members of the Board. Amtrak is also subject to the Freedom of Information Act. Amtrak's equity structure is similarly suggestive. As of September 30, 2011, four common stockholders owned 9,385,694 outstanding shares, which they acquired from the four railroads whose intercity passenger service Amtrak assumed in 1971. At the same time, however, the federal government owned all 109,396,994 shares of Amtrak's preferred stock, each share of which is convertible into 10 shares of common stock. And, all that stands between Amtrak and financial ruin is congressional largesse.

That being said, Amtrak's legislative origins are not determinative of its constitutional status. Congress's power to charter private corporations was recognized early in our nation's history. And, as far as Congress was concerned, that is exactly what it was doing when it created Amtrak. As Congress explained it, Amtrak “shall be operated and managed as a for-profit corporation” and “is not a department, agency, or instrumentality of the United States Government.” We have previously taken Congress at its word and relied on this declaration in deciding whether the False Claims Act applies to Amtrak. Amtrak agrees: “The National Railroad Passenger Corporation, also known as Amtrak, is not a government agency or establishment [but] a private corporation operated for profit.” And, somewhat tellingly, Amtrak's website is www.amtrak.com—not www.amtrak.gov.

How to decide? Since, in support of its claim that Amtrak is a public entity, the government looks past labels to how the corporation functions, it is worth examining what functional purposes the public-private distinction serves when it comes to delegating regulatory power. We identify two of particular importance. First, delegating the government's powers to private parties saps our political system of democratic accountability. This threat is particularly dangerous where both Congress and the Executive can deflect blame for unpopular policies by attributing them to the choices of a private entity. This worry is certainly present in the case of § 207, since Congress has expressly forsworn Amtrak's status as a “department, agency, or instrumentality of the United States Government.” Dislike the metrics and standards Amtrak has concocted? It's not the federal government's fault—Amtrak is a “for-profit corporation.”

Second, fundamental to the public-private distinction in the delegation of regulatory authority is the belief that disinterested
government agencies ostensibly look to the public good, not private gain. For this reason, delegations to private entities are particularly perilous. 

*Carter Coal* specifically condemned delegations made not “to an official or an official body, presumptively disinterested, but to private persons whose interests may be and often are adverse to the interests of others in the same business.” Partly echoing the Constitution's guarantee of due process, this principle ensures that regulations are not dictated by those who “are not bound by any official duty,” but may instead act “for selfish reasons or arbitrarily.” More recent decisions are also consistent with this view. Amtrak may not compete with the freight railroads for customers, but it does compete with them for use of their scarce track. Like the “power conferred upon the majority ... to regulate the affairs of an unwilling minority” in *Carter Coal*, § 207 grants Amtrak a distinct competitive advantage: a hand in limiting the freight railroads' exercise of their property rights over an essential resource.

Because Amtrak must “be operated and managed as a for-profit corporation,” the fact that the President has appointed the bulk of its Board does nothing to exonerate its management from its fiduciary duty to maximize company profits. Also consistent with this purpose, “Amtrak is encouraged to make agreements with the private sector and undertake initiatives that are consistent with good business judgment and designed to maximize its revenues and minimize Government subsidies.” Yet § 207 directs Amtrak and its host carriers to incorporate the metrics and standards in their Operating Agreements. So to summarize: Amtrak must negotiate contracts that will maximize its profits; those contracts generally must, by law, include certain terms; and Amtrak has the power to define those terms. Perverse incentives abound. Nothing about the government's involvement in Amtrak's operations restrains the corporation from devising metrics and standards that inure to its own financial benefit rather than the common good. And that is the very essence of the public-private distinction when a claim of unconstitutional delegation arises.

No discussion of Amtrak's status as a private or public institution would be complete, however, without an examination of the Supreme Court's decision in *Lebron v. National Railroad Passenger Corp*. There the Court held that Amtrak “is part of the Government for purposes of the First Amendment.” Otherwise, the majority cautioned, the government could “evade the most solemn obligations imposed in the Constitution by simply resorting to the corporate form.” What the Court did not do in *Lebron* was conclude that Amtrak counted as part of the government for all purposes. On some questions—Does the Administrative Procedure Act apply to Amtrak? Does Amtrak enjoy sovereign immunity from suit?—Congress’s disclaimer of Amtrak's governmental status is dispositive. This makes sense: Congress has the power to waive certain governmental privileges, like sovereign immunity, that are within its legislative control; but it cannot circumvent the Bill of Rights by simply dubbing something private.
Whether § 207 effects an unconstitutional delegation is a constitutional question, not a statutory one. But just because LeBron treated Amtrak as a government agency for purposes of the First Amendment does not dictate the same result with respect to all other constitutional provisions. To view LeBron in this way entirely misses the point. In LeBron, viewing Amtrak as a strictly private entity would have permitted the government to avoid a constitutional prohibition; in this case, deeming Amtrak to be just another governmental entity would allow the government to ignore a constitutional obligation. Just as it is impermissible for Congress to employ the corporate form to sidestep the First Amendment, neither may it reap the benefits of delegating regulatory authority while absolving the federal government of all responsibility for its exercise. The federal government cannot have its cake and eat it too. In any event, LeBron’s holding was comparatively narrow, deciding only that Amtrak is an agency of the United States for the purpose of the First Amendment. It did not opine on Amtrak’s status with respect to the federal government’s structural powers under the Constitution—the issue here.

This distinction is more than academic. When LeBron contrasted “the constitutional obligations of Government” from “the ‘privileges of the government,’ ” it was not drawing a distinction between questions that are constitutional from those that are not. Any “privilege” of the federal government must also be anchored in the Constitution. As our federal government is one of enumerated powers, the Constitution's structural provisions are the source of Congress’s power to act in the first place. And, generally speaking, these provisions authorize action without mandating it. Congress's power to regulate interstate commerce, for example, does not dictate the enactment of this or that bill within its proper scope. By contrast, individual rights are “affirmative prohibitions” on government action that become relevant “only where the Government possesses authority to act in the first place.” While often phrased in terms of an affirmative prohibition, Congress's inability to delegate government power to private entities is really just a function of its constitutional authority not extending that far in the first place. In other words, rather than proscribing what Congress cannot do, the doctrine defines the limits of what Congress can do. And, by designing Amtrak to operate as a private corporation—to seek profit on behalf of private interests—Congress has elected to deny itself the power to delegate it regulatory authority under § 207.

We therefore hold that Amtrak is a private corporation with respect to Congress's power to delegate regulatory authority. Though the federal government's involvement in Amtrak is considerable, Congress has both designated it a private corporation and instructed that it be managed so as to maximize profit. In deciding Amtrak's status for purposes of congressional delegations, these declarations are dispositive. Skewed incentives are precisely the danger forestalled by restricting delegations to government instrumentalities. And as a private entity,
Amtrak cannot be granted the regulatory power prescribed in § 207.

III

We conclude § 207 of the PRIIA impermissibly delegates regulatory authority to Amtrak. We need not reach AAR's separate argument that Amtrak's involvement in developing the metrics and standards deprived its members of due process. Accordingly, the judgment of the district court is

Reversed.
The U.S. Supreme Court on Monday said it would decide whether Amtrak should be allowed to participate in the development of rail performance measures with a government agency.

Congress set up the arrangement in a 2008 law that allowed Amtrak to work with the Federal Railroad Administration to set metrics and minimum standards for assessing the performance of the passenger rail service. Those standards are supposed to be incorporated into Amtrak's operating agreements with the freight railroad companies, which host Amtrak trains on their tracks.

Freight railroads potentially can be penalized if Amtrak fails to meet performance standards because the freights didn't give Amtrak trains priority use of the rail lines.

The railroads found the adopted performance metrics to be unrealistic and said the law's grant of authority to Amtrak was unprecedented and untenable. They argued that Congress violated the Constitution by delegating authority to a private entity.

A federal appeals court in Washington, D.C., agreed.

The appeals court acknowledged that Amtrak "is a curious entity" that straddles the public and private sectors, but it noted that Amtrak was a for-profit corporation. It struck down the arrangement as unconstitutional, suggesting the unusual setup wasn't much different than giving General Motors authority to help write government regulations that would govern all auto makers.

The Justice Department asked the Supreme Court to review the case, saying the government retained sufficient control over the Amtrak performance standards to avoid any constitutional concerns.

The Supreme Court will consider the case, Department of Transportation v. Association of American Railroads, during its next term, which begins in October.
In 2008, Congress passed PRIIA (Passenger Rail Improvement and Investment Act). Among its many provisions, it allows Amtrak to work with the Federal Railroad Administration to set metrics and minimum standards for assessing passenger rail service performance. Those standards are meant to be incorporated into Amtrak’s operating agreements with its host freight railroads.

Freight railroads can be penalized if Amtrak fails to meet its own performance standards, particularly if Amtrak trains have not been given priority on the freight rights-of-way it uses. The Association of American Railroads strongly objected, calling the law unrealistic and saying that giving authority to Amtrak to participate in the development of rail performance measures with a government agency was unprecedented and untenable. They argued that Congress violated the Constitution by delegating authority to a private entity.

A federal DC Circuit appeals court in Washington, D.C. agreed, calling Amtrak “a curious entity” that straddles the public and private sectors, but still a for-profit corporation. It struck down the PRIIA provision as unconstitutional, suggesting the unusual setup was equivalent to giving General Motors authority to help write government regulations that would govern all auto makers.

At the request of the U.S. Department of Justice, the U.S. Supreme Court will consider the case, Department of Transportation vs. Association of American Railroads, during its next term, which begins in October. DOJ said the government should retain sufficient control over Amtrak performance standards to avoid any constitutional concerns.

“The issue in the case is whether PRIIA Section 207, which required the FRA and Amtrak to jointly develop metrics, is an unconstitutional delegation of Congress’ legislative power to a private entity,” says Kevin Sheys, a railroad attorney with Nossaman LLP of Washington, D.C. “The metrics have many purposes, but the important one for this case is that they could be used to measure whether the freights were meeting their statutory obligation to give preference to Amtrak’s passenger trains.”

“The Supreme Court will need to grapple with whether Amtrak is a private entity for purposes of PRIIA Section 207 and, if so, whether Amtrak had too much influence over the development of the metrics,” Sheys observes. “The USDOT will argue that Amtrak is not a private entity for 207 purposes and in any case it did not have too much influence over the development of the metrics. The freights, represented by the AAR, believe the DC Circuit properly decided the case and probably will make a
second argument (not reached by the DC Circuit) that the metrics violate their Fifth Amendment due process rights.”
Amtrak, the U.S. long-distance passenger railroad, lost its power to assess blame when its trains are delayed and to have a say in whether freight railroads causing those holdups are penalized.

The U.S. Court of Appeals in Washington yesterday ruled the taxpayer-supported service is a private company to which Congress improperly gave regulatory power over freight railroads such as Union Pacific Corp. (UNP) and Warren Buffett’s Burlington Northern Santa Fe.

The court threw out a law passed to enforce a requirement, dating to Amtrak’s creation in 1970, that freight trains give priority to passenger trains on tracks they share, which they do in most of the U.S.

“If freight railroads perceive they no longer face penalties for giving freight trains priority over passenger trains, and the passenger-train delays are extensive, the result could be a de-facto imploding of Amtrak,” said Frank Wilner, a transportation economist and author of “Amtrak: Past, Present and Future,” published last year.

The case involves on-time performance standards and enforcement mechanisms established under the Passenger Rail Investment and Improvement Act of 2008.

Amtrak, based in Washington, tracks and publishes, in monthly reports on its website, how many minutes its trains are delayed each month and assigns causes. It cited freight-train interference as the most common type of delay over the past 12 months.

During April, it said, such interference was responsible for about 55,000 minutes of delays, or 14.9 percent of the total.

Canadian National Railway Co. (CNI) was held responsible for the most delays in the 12 months ending in April.

**General Motors**

If Amtrak trains don’t meet the on-time performance standards set by the company and its regulators, the U.S. Surface Transportation Board can investigate the railroads whose tracks they use and assess damages.

The court ruled the law unconstitutional for giving Amtrak a say in setting the metrics that could lead to penalties. U.S. Circuit Judge Janice Rogers Brown said that was akin to the government giving General Motors Co. (GM) the power to regulate automobile manufacturers.

“It appears that the current metrics and standards are invalid until Congress rewrites the law,” said Ross Capon, president of the National Association of Railroad Passengers, a Washington-based advocacy group, in an interview.

Steve Kulm, a spokesman for Amtrak, declined to comment.
Delays Reduced

The U.S. Federal Railroad Administration, which wrote the standards, said they’ve been a useful tool to reduce Amtrak delays.

“Since the establishment of the metrics and standards in 2010, delays have been reduced each successive year, culminating in a historic best for Amtrak in 2012,” said Kevin Thompson, a spokesman for the agency. “But there is still need for additional improvement.”

The Transportation Department inspector general in 2008 found Amtrak’s on-time performance of 30 percent on long-distance routes in 2006 reduced the railroad’s revenue and increased the demand for taxpayer subsidies.

The Association of American Railroads, whose members include freight railroads and Amtrak, sued the U.S. Transportation Department in 2011 arguing that the standards, which Amtrak drafted with Federal Railroad Administration, forced freight railroads to substantially alter their business operations, at times by delaying their own freight traffic.

Bilateral Contracts

The rail association, based in Washington, hailed the ruling.

“Freight railroads recognize Amtrak wants to run trains on time, and they work closely with Amtrak to help make this happen,” Ed Hamberger, the group’s chief executive officer, said in an e-mailed statement.

“However, freight railroads believe setting and measuring schedules and on-time performance metrics should not be done through a one-size-fits all approach at the federal level, but addressed jointly through private bilateral contracts that take into account the facts and circumstances of particular routes.”

On July 2, 2013, in Ass’n of American Railroads v. DOT, the D.C. Circuit struck down a delegation of authority to Amtrak in § 207 of the Passenger Rail Investment and Improvement Act of 2008, holding that the statute unconstitutionally delegated regulatory power to a private party. This is a significant case for several reasons.

First, it’s potentially significant in terms of constitutional doctrine. In holding that private delegations of regulatory authority are illegitimate, the case seems to go against the conventional wisdom, which is that there is no special doctrine for private delegations by Congress: the Nondelegation Doctrine applies equally to public and private recipients of delegated congressional authority by Congress. Moreover, this conventional wisdom is probably right. The D.C. Circuit’s decision may yet be correct under the Due Process Clause, but the D.C. Circuit deliberately refused to choose whether this delegation implicated the Nondelegation Doctrine or the Due Process Clause.

Second, it's potentially significant in terms of its real-world effect on delegations to private parties—though, again, much depends on precisely why the delegation is unconstitutional. If the decision rests on the Nondelegation Doctrine, it only affects federal delegations; but if it rests on the Due Process Clause, it also affects the much broader set of state delegations.

Third, in holding, based on a multi-factor analysis, that Amtrak is a private actor, it provides yet another example of how the public-private distinction is fuzzy, and an entity that is public for one reason might be private for another.

Amtrak, formally called the National Railroad Passenger Corporation, was created by statute in 1970. Faced with competition from other modes of transport, railroads that offered passenger service had been incurring heavy losses; many of these railroads had petitioned the Interstate Commerce Commission, which at the time regulated railroads, for permission to stop providing passenger service. With the passage of the statute, a railroad could transfer its passenger service responsibilities to Amtrak if it agreed to a number of conditions, one of which was to grant Amtrak the use of its tracks and other facilities. The statute provides that, except in an emergency, an Amtrak passenger car has precedence over another railroad’s freight car when they both need to use the same facilities. Most railroads agreed to these conditions, which were enshrined in a series of bilateral operating agreements.

Fast forward a few decades, to when Congress passed the Passenger Rail Investment and Improvement Act of 2008. One section of the new statute, § 207, required the Federal Railroad Administration (FRA) and Amtrak to
“jointly . . . develop new or improve existing metrics and minimum standards for measuring the performance and service quality of intercity passenger train operations, including cost recovery, on-time performance and minutes of delay, ridership, on-board services, stations, facilities, equipment, and other services.” These performance measures aren’t of merely academic interest. Amtrak and its contractual partners are required to incorporate the measures into their operating agreements “[t]o the extent practical.” Perhaps more seriously, if “on-time performance” or “service quality” is substandard for two consecutive quarters, the Surface Transportation Board (STB), an independent agency housed in the Department of Transportation, is allowed to start an investigation (and is required to do so, if a complaint is filed) to check whose fault it is, and can assess damages against the host railroad if the problems are due to the railroad’s failure to grant preference to Amtrak trains.

These metrics and standards are supposed to be developed “jointly” by Amtrak and the FRA. If they can’t agree, they can petition the STB to appoint an arbitrator, whose decision will be binding. Amtrak thus has equal authority with the FRA on this issue; the FRA has to get Amtrak’s consent in developing the metrics and standards (or it has to abide by the decision of an arbitrator, who might also end up being private). The Association of American Railroads sued, charging that this sort of private delegation is invalid; and the D.C. Circuit agreed.

First, the D.C. Circuit noted, “[f]ederal lawmakers cannot delegate regulatory authority to a private entity.” The Nondelegation Doctrine states that when Congress delegates power to a government agency, all that’s required is that Congress provide an “intelligible principle” to limit the agency’s discretion. But, said the D.C. Circuit, “[e]ven an intelligible principle cannot rescue a statute empowering private parties to wield regulatory authority.” To illustrate this point, the D.C. Circuit cited Carter v. Carter Coal Co. (1936). The New Deal-era Congress had established a National Bituminous Coal Commission and required the organization of 23 “coal districts.” Within each coal district, all coal producers would be bound by any collective bargaining agreements agreed to by a majority of producers (representing two-thirds of total tonnage) and representatives of a majority of workers. In other words, 2/3 of the coal industry could, by its collective bargaining activity, legally bind the remaining 1/3 of the industry. (This reliance on massive binding industry self-regulation was classic New Deal procedure.) The Supreme Court struck this down: “The power conferred upon the majority is, in effect, the power to regulate the affairs of an unwilling minority. This is legislative delegation in its most obnoxious form; for it is not even delegation to an official or an official body, presumptively disinterested, but to private persons whose interests may be and often are adverse to the interests of others in the same business. The delegation is clearly arbitrary, and clearly a denial of rights safeguarded by the due process clause of the Fifth Amendment.”
To the D.C. Circuit, the question thus became: “precisely how much involvement may a private entity have in the administrative process before its advisory role trespasses into an unconstitutional delegation?” The court distinguished two relatively old cases where the Supreme Court had upheld private delegations: *Currin v. Wallace* (1939) and *Sunshine Anthracite Coal Co. v. Adkins* (1940). In *Currin*, an agency wrote regulations for tobacco auction markets, but they wouldn’t take effect unless two-thirds of the industry approved. The Supreme Court held that this was unobjectionable, because (unlike in *Carter Coal*) private parties did no more than hold the on-off switch for regulations that were written by the government. In *Adkins*, the fact pattern was reminiscent of *Carter Coal*: in fact, Congress had reenacted the same statute that the Supreme Court had struck down in *Carter Coal*, with the exception that now the government agency wrote the regulations for the industry based on the industry’s recommendation. The Supreme Court upheld this scheme, since now the industry was merely subordinate to the government agency. (The possible reality that the agency might just rubber-stamp the industry’s recommendations was irrelevant to the analysis: what was important was that the agency had the legal authority to modify the recommendations if it wanted to.)

The Amtrak case, though, went far beyond *Currin or Adkins* and was more similar to *Carter Coal*: Amtrak had an “effective veto” over FRA regulations and, in fact, enjoyed “authority equal to the FRA.” This really was a case where a private actor could control the regulations that governed the rest of the railroad industry, choosing a set of performance measures that would tend to make it look good relative to its competitors—and if the FRA refused to accede to Amtrak’s demands, the regulations would be written by an arbitrator chosen by the STB who could, for all we know, also be a private party.

Not so fast, though; one might legitimately argue that Amtrak isn’t private. The hazard with all such doctrines that draw a bright line between public and private is that, in reality, the line is somewhat fuzzy, especially in an age where contracting out of government services and pervasive regulation of the private sector are widespread.

So let’s tally up the indicia of privateness and publicness. On the public side, Amtrak’s Board of Directors has nine members, one of whom is the Secretary of Transportation and seven of whom are presidential appointees; the ninth, the President of Amtrak, is elected by the other eight. Amtrak has some private shareholders, but almost all its stock is preferred stock held by the federal government. The D.C. Circuit noted that Amtrak gets substantial subsidies from the federal government—though the amount of government money one gets generally isn’t relevant to whether one is public or private.

Notably, still on the public side, there’s a Supreme Court case, *Lebron v. National Railroad Passenger Corp.* (1995). In *Lebron*, Amtrak was sued, mostly on First Amendment grounds, for refusing to display a political advertisement in New York’s
Penn Station. First Amendment rights, like many other constitutional rights, only apply against “state actors,” so the question was whether Amtrak was a state actor. The Supreme Court held that “where, as here, the Government creates a corporation by special law, for the furtherance of governmental objectives, and retains for itself permanent authority to appoint a majority of the directors of that corporation, the corporation is part of the Government for purposes of the First Amendment.”

On the private side, the 1970 statute specifies that Amtrak “is not a department, agency, or instrumentality of the United States Government.” The statute also commands that Amtrak “shall be operated and managed as a for-profit corporation.” Relatedly, by statute, “Amtrak is encouraged to make agreements with the private sector and undertake initiatives that are consistent with good business judgment and designed to maximize its revenues and minimize Government subsidies.” Amtrak itself announces that it’s “not a government agency or establishment [but] a private corporation operated for profit.” The D.C. Circuit attaches some significance (“somewhat tellingly”) to the fact that Amtrak’s URL is amtrak.com—not amtrak.gov—but this doesn’t really seem all that telling, as one could make a similar claim about the U.S. Postal Service at usps.com.

To decide the issue, the D.C. Circuit looked to “what functional purposes the public-private distinction serves when it comes to delegating regulatory power.” One purpose is accountability: a private delegation dilutes democratic accountability, because when power is delegated to a private organization, the government is no longer blamed for that organization’s decisions. (Perhaps; but if something goes wrong, why can’t the voters blame the government for the initial decision to delegate?) Another purpose is the distinction between the public good and private gain: public recipients of delegated power are “presumptively disinterested” and are bound by “official duty,” whereas private recipients may act “for selfish reasons or arbitrarily.” (Perhaps; but doesn’t this display an overly optimistic view of the motivations of public employees?) In the D.C. Circuit’s view, these considerations cut in favor of treating Amtrak as private: the statutory command that it be “managed as a for-profit corporation” requires that it seek its private good, not the public good, and Congress’s and Amtrak’s consistent labeling of Amtrak as private tends to distance Amtrak’s decisions from democratic accountability. (The court distinguished Lebron on the grounds that being a state actor for First Amendment purposes doesn’t mean one is a state actor for all purposes.) Section 207 thus delegates regulatory power to a private party, and is thus invalid.

One interesting aspect of Ass’n of American Railroads v. DOT is the idea that Amtrak can be private for the purposes of structural provisions like the Nondelegation Doctrine, even though it is public for the purposes of individual-rights provisions like the First Amendment. This is possible, though the D.C. Circuit’s multi-factor analysis isn’t exactly overwhelming.
A more interesting aspect of the case is what the court relegates to a footnote and refuses to decide. Recall the *Carter Coal* precedent from 1936, where giving businesses the power to regulate their competitors was characterized as “legislative delegation in its most obnoxious form.” *Carter Coal* is, unfortunately, less than crystal-clear on the precise source of the unconstitutionality. Since it mentions “legislative delegation,” one could think of it (as the D.C. Circuit did) as a Nondelegation Doctrine decision. Nondelegation challenges rest on the Vesting Clause of Article I of the federal constitution, which vests all legislative power in Congress (“All legislative powers herein granted shall be vested in a Congress of the United States.”). Congress must exercise its own legislative power, but it’s allowed to delegate limited authority as long as the delegation is accompanied by some “intelligible principle” to limit the agency’s discretion.

But *Carter Coal* also says that the delegation is “clearly a denial of rights safeguarded by the due process clause of the Fifth Amendment” (“[N]or shall any person . . . be deprived of life, liberty, or property, without due process of law”).

So is this a Nondelegation Doctrine decision or a Due Process Clause decision? The D.C. Circuit wasn’t that interested in precisely what part of the Constitution was being violated. It wrote, in a footnote, that “the distinction evokes scholarly interest,” but the parties in this case didn’t press the point, and “neither court nor scholar has suggested a change in the label would effect a change in the inquiry.”

But reading *Carter Coal* as a Due Process opinion, and likewise grounding the Amtrak challenge in the Due Process Clause, makes more sense. The focus of a nondelegation challenge should be on how much power Congress has given up—has it actually given up legislative power, or has it merely allowed someone to fill gaps and ambiguities?—not on the identity of the recipient of the delegation. The Due Process Clause, on the other hand, is concerned with fair treatment, and the idea that financially biased decisionmakers (whether public or private) are illegitimate has been a staple of Due Process doctrine for a long time. Claims of bias, whether it’s a public official who has prejudged an issue or a private organization that can lose money depending on how it wields its power, thus fit more naturally into a Due Process framework than into a nondelegation framework.

Moreover, the distinction matters for future cases. A nondelegation holding based on Article I’s Vesting Clause would enforce the federal separation of powers by preventing Congress from getting rid of some of its legislative authority, and so it would only govern federal delegations. These separation of powers constraints are irrelevant for the states. The federal constitution doesn’t require that states have the same separation of powers as the federal government: states could adopt parliamentary democracy or engage in any number of structural experiments forbidden to the federal government, provided they comply with certain minimal guarantees like “one-person, one-vote” or having a “republican form of government.”
A Due Process challenge would be quite different: like the First Amendment and most other Bill of Rights provisions, the Due Process Clause now applies against the states, so a Due Process holding would also constrain state delegations and would therefore have a much wider sweep. Under the Due Process Clause, the court wouldn’t do the public/private inquiry that was on display here; rather, it would look to whether Amtrak was a state actor using the substantial body of state action doctrine. But this question was already resolved in 1995 by the *Lebron* case: yes, Amtrak is a state actor. (*Lebron* arose in a First Amendment context, but it turns out that the Due Process Clause, as well as various other individual-rights provisions, turns on the same state action question, so any finding of state action for First Amendment purposes carries over directly to the Due Process Clause.) Finding that Amtrak is a state actor doesn’t mean there’s a Due Process violation; it’s only a threshold step that means that Due Process protections apply. To find out whether the Due Process Clause was violated, the relevant inquiry would be the extent of Amtrak’s financial bias. And given the statutory command that Amtrak act to maximize its profits, one could legitimately conclude that it couldn’t, without an unconstitutional conflict of interest, regulate the rest of the railroad industry—thus arriving at the same bottom line as the D.C. Circuit.

The D.C. Circuit thus seems incorrect when it says that public delegations of regulatory authority are merely evaluated by the “intelligible framework” test while private delegations are per se illegitimate. Rather, all *federal* delegations (public or private) are evaluated by the “intelligible principle” test, while all delegations of any kind (state or federal, public or private) are scrutinized for conflicts of interest under the Due Process Clause, and perhaps private delegations might be more vulnerable because conflicts of interest are more likely to arise there.

This, then, is the open issue at the heart of the D.C. Circuit’s opinion. The true reach of this decision is yet to be determined.
Direct Marketing Association v. Brohl

13-1032


Association of mail and online retailers brought action against Executive Director of Colorado Department of Revenue, challenging the constitutionality of notice and reporting requirements that state imposed on retailers that did not collect taxes on sales to Colorado purchasers. The United States District Court for the District of Colorado, Robert Blackburn, J., granted summary judgment to association and permanently enjoined enforcement of requirements on ground that they violated Commerce Clause. Defendant appealed.

Question Presented: Whether the Tax Injunction Act, which provides that “[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State,” bars federal court jurisdiction over a suit brought by non-taxpayers to enjoin the informational notice and reporting requirements of a state law that neither imposes a tax, nor requires the collection of a tax, but serves only as a secondary aspect of state tax administration.

DIRECT MARKETING ASSOCIATION, Plaintiff-Appellee,

v.

Barbara BROHL, in her capacity as Executive Director, Colorado Department of Revenue, Defendant-Appellant, and Multistate Tax Commission, Amicus-Curiae.

United States Court of Appeals, Tenth Circuit

Decided on August 20, 2013

[Excerpt; some footnotes and citations omitted.]

MATHESON, Circuit Judge.

This appeal arises from Colorado's efforts to collect sales and use taxes during the expansion of e-commerce.

Appellant Barbara Brohl, Executive Director of the Colorado Department of Revenue (the "Department"), appeals from an order enjoining the enforcement of state notice and reporting requirements imposed on retailers who do not collect taxes on sales to Colorado purchasers ("non-collecting retailers"). Most, if not all, of these non-collecting retailers sell products to Colorado purchasers by mail or online.

Appellee Direct Marketing Association ("DMA") — a group of businesses and organizations that market products via catalogs, advertisements, broadcast media, and the Internet — urges us to uphold the district court's determination that Colorado's notice and reporting obligations are
unconstitutional. The district court concluded that Colorado's requirements for non-collecting retailers discriminated against and placed undue burdens on interstate commerce, in violation of the Commerce Clause of the United States Constitution. It therefore entered a permanent injunction prohibiting enforcement of the state requirements.

The issue in this appeal is whether Colorado's notice and reporting obligations for non-collecting retailers violate the Commerce Clause. However, we do not reach that merits question. Because the Tax Injunction Act, 28 U.S.C. § 1341, deprived the district court of jurisdiction to enjoin Colorado's tax collection effort, we remand to the district court to dismiss DMA's Commerce Clause claims.

I BACKGROUND

A. Colorado's Sales and Use Taxes

Colorado imposes a 2.9 percent tax on the sale of tangible goods within the state. Retailers with a physical presence in the state are required by law to collect sales tax from purchasers and remit it to the Department. The sales tax statute imposes additional duties on Colorado retailers such as recordkeeping, and penalties for deficient remittance of sales tax.

If Colorado purchasers have not paid sales tax on tangible goods — as occurs in some online and mail-order purchases from retailers with no in-state physical presence — they must pay a 2.9 percent use tax "for the privilege of storing, using, or consuming" the goods in Colorado. The use tax complements the sales tax and is "prevent[] consumers of retail products from purchasing out of state in order to avoid paying a Colorado sales tax."

Although Colorado's sales and use taxes have equivalent rates, they are collected differently. Whereas retailers with a physical presence in the state must collect and remit sales tax to the Department, the onus is on the purchaser to report and pay use tax. This difference results from the Supreme Court's bright-line rule in Quill Corp. v. North Dakota. In Quill, the Court reaffirmed that it is unconstitutional under the "negative" or "dormant" aspect of the Commerce Clause for a state to require a retailer with no in-state physical presence to collect the state's sales or use taxes. Because Quill prohibits Colorado from forcing retailers with no in-state physical presence to collect and remit taxes on sales to Colorado consumers, the state requires its residents to report and pay use taxes to the Department with their income tax returns. The failure to report and pay use tax is a criminal offense.

Nonetheless, use tax collection is elusive. Most Colorado residents do not report or remit use tax despite the legal obligation to do so. A 2010 report submitted as part of this litigation estimated that Colorado state and local governments would lose $172.7 million in 2012 because of residents' failure to pay use tax on e-commerce purchases from out-of-state, non-collecting retailers.

B. Notice and Reporting Requirements

To increase use tax collection, in 2010 the Colorado legislature enacted statutory requirements for non-collecting retailers. The statute and its implementing regulations
impose three principal obligations on non-collecting retailers whose gross sales in Colorado exceed $100,000; they must (1) provide transactional notices to Colorado purchasers, (2) send annual purchase summaries to Colorado customers, and (3) annually report Colorado purchaser information to the Department.

Under the first requirement, non-collecting retailers must "notify Colorado purchasers that sales or use tax is due on certain purchases . . . and that the state of Colorado requires the purchaser to file a sales or use tax return." The notice must be included in every transaction with a Colorado purchaser, and shall inform the purchaser that (1) the retailer has not, collected sales or use tax, (2) the purchase is not exempt from Colorado sales or use tax, and (3) Colorado law requires the purchaser to file a sales or use tax return and to pay tax owed. According to the Department, the transactional notice "serves to educate consumers about their state use tax liability with the aim of increasing voluntary compliance."

Under the second requirement, non-collecting retailers must mail annual notices to Colorado customers who purchased more than $500 in goods from them in the preceding calendar year. The summary must be sent by January 31 of each year and the envelope containing it must be "prominently marked with the words 'Important tax document enclosed.'" The summary must inform Colorado consumers of purchase dates, items bought, and the amount of each purchase made in the preceding calendar year. The annual summary tells purchasers they have a duty to "file a sales or use tax return at the end of every year" in Colorado and must inform customers that the retailer is required to report to the Department the customers' total purchase amounts from the preceding calendar year. According to the Department, the annual summary "arms the consumer with accurate information to facilitate reporting and paying the use tax."

Third, non-collecting retailers must annually report information on Colorado purchasers to the Department. The annual report shall include purchasers' names, billing addresses, shipping addresses, and total purchase amounts for the previous calendar year. According to the Department, this customer information report "allows [it] to pursue audit and collection actions against taxpayers who fail to pay the tax" and "is designed to increase voluntary consumer compliance with state tax laws because consumers know that a third party has reported their taxable activity to the taxing authority."

Non-collecting retailers who do not comply with any one of Colorado's notice and reporting obligations are subject to penalties. Alternatively, retailers may choose to collect and remit sales tax from Colorado purchasers to forgo the notice and reporting obligations.

C. Procedural History

In June 2010, DMA sued the Department's executive director, challenging the constitutionality of Colorado's notice and reporting requirements. Claims I and II of DMA's complaint alleged that Colorado's statutory and regulatory obligations are
unconstitutional under the Commerce Clause because they (1) discriminate against interstate commerce ("Discrimination Claim"), and (2) impose undue burdens on interstate commerce ("Undue Burden Claim").

The district court granted DMA a preliminary injunction prohibiting the enforcement of the notice and reporting requirements. The parties then agreed to an expedited process for resolving the two Commerce Clause claims and filed cross-motions for summary judgment on those claims.

On March 30, 2012, the district court granted DMA's motion for summary judgment and denied the Department's motion for summary judgment. On the Discrimination Claim, the court concluded that the notice and reporting requirements facially discriminate against interstate commerce. It held these requirements are unconstitutional because "[t]he record contains essentially no evidence to show that the legitimate interests advanced by the [Department] cannot be served adequately by reasonable nondiscriminatory alternatives."

On the Undue Burden Claim, the district court relied on Quill's bright-line rule that state governments cannot constitutionally require businesses without an in-state physical presence to collect and remit sales or use taxes. The district court acknowledged that Colorado's notice and reporting requirements do not obligate out-of-state retailers to collect and remit taxes. But it reasoned that the notice and reporting requirements place burdens on out-of-state retailers that "are inextricably related in kind and purpose to the burdens condemned in Quill" These burdens, the district court concluded, would unconstitutionally interfere with interstate commerce.

In the same order, the court entered a permanent injunction prohibiting enforcement of the notice and reporting requirements. In granting injunctive relief, the district court said DMA had achieved actual success on the merits because the court had granted summary judgment on the Discrimination and Undue Burden Claims.

Because DMA's non-Commerce Clause claims remained unresolved, the district court said it would "address in a separate order the parties' request that [it] certify this order as a final judgment under Fed.R.Civ.P. 54(b)," from which the Department could appeal. However, the Department filed its notice of appeal before the district court certified the order as final under Fed.R.Civ.P. 54(b). We nevertheless may consider the Department's appeal from the district court's entry of a permanent injunction under 28 U.S.C. § 1292(a)(1) (providing jurisdiction over interlocutory orders granting injunctions).

II. DISCUSSION

The issue on appeal is whether Colorado's notice and reporting requirements for non-collecting retailers violate the dormant Commerce Clause. Before addressing that issue, however, we must determine whether the Tax Injunction Act ("TLA") precludes federal jurisdiction over DMA's claims. We conclude that it does and do not reach the merits of this appeal.
A. Tax Injunction Act

The TIA provides that "district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." The statute has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operations." It therefore serves as a "broad jurisdictional barrier" that "limit[s] drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." Because the TIA is a jurisdictional limitation, we must determine whether it prohibits our consideration of this appeal regardless of whether it was raised in the district court.

The TIA prohibits our jurisdiction if (1) DMA's action seeks to "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law," and (2) "a plain, speedy and efficient remedy may be had in the courts of such State," id. We address these issues in turn.

1. Does DMA seek to enjoin, suspend, or restrain the assessment, levy or collection of a state tax?

The TIA divests federal district courts of jurisdiction over actions that seek to "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law." This broad language prohibits federal courts from interfering with state tax administration through injunctive relief, declaratory relief, or damages awards. The TIA "does not limit any substantive rights to enjoin a state tax but requires only that they be enforced in a state court rather than a federal court."

In its brief, DMA argues the TIA does not preclude federal jurisdiction here because DMA (1) is not a taxpayer seeking to avoid a tax, and (2) challenges notice and reporting requirements, not a tax assessment.

a. Non-taxpayer lawsuits

DMA argues it is not a taxpayer seeking to avoid state taxes and thus the TIA does not apply. Its argument rests on Hibbs v. Winn, where the Supreme Court stated that the TIA is triggered when "state taxpayers seek federal-court orders enabling them to avoid paying state taxes." Relying on our precedent interpreting Hibbs, we disagree that the TIA applies only when taxpayers seek to avoid a state tax in federal court.

The plaintiffs in Hibbs were Arizona taxpayers who brought an Establishment Clause challenge in federal court to a state tax credit for contributions to "school tuition organizations." The plaintiffs did not challenge a tax imposed on them, but a tax benefit to others. The Supreme Court determined the TIA did not bar such a lawsuit.

The Court observed that Congress enacted the TIA to "direct[] taxpayers to pursue refund suits instead of attempting to restrain [state tax] collections" through federal lawsuits. "In short," the Court said, "Congress trained its attention on taxpayers who sought to avoid paying their tax bill by pursuing a challenge route other than the one specified by the taxing authority."
Beyond this discussion of taxpayer lawsuits, the Hibbs Court explained that the TIA applies to federal court relief that "would . . . operate[] to reduce the flow of state tax revenue" — i.e., federal lawsuits that would inhibit state tax assessment, levy, or collection. According to the statute's legislative history, Congress enacted the TIA with "state-revenue-protective objectives," including prohibiting "taxpayers, with the aid of a federal injunction, from withholding large sums, thereby disrupting state government finances." The Court noted that the Hibbs plaintiffs did not challenge a state-revenue-producing measure — they sought to invalidate a tax credit the state gave to taxpayers — and that nothing in the TIA prohibited a third party from challenging a state tax benefit in federal court.

Although Hibbs states that the TIA applies to "cases in which state taxpayers seek federal-court orders enabling them to avoid paying state taxes," we have not interpreted it as holding that the TIA applies only to taxpayer suits. For instance, in Hill v. Kemp, we applied the TIA outside the context of a taxpayer seeking to avoid taxes. In Hill, Oklahoma motorists and abortion-rights supporters sought to enjoin Oklahoma's statutory scheme for specialty vehicle license plates. The plaintiffs argued that Oklahoma unconstitutionally discriminated against their viewpoint by giving more favorable terms and conditions to drivers who wanted specialty plates with anti-abortion messages.

We agreed with the district court that the TIA barred the plaintiffs' challenge because Oklahoma's specialty license plate scheme imposed revenue-generating charges, which we viewed as taxes. To enjoin the "entire specialty plate regime . . . or even to enjoin a portion of it," we said, "would deny Oklahoma the use of significant funds" used for a variety of state initiatives. Such a result "would implicate exactly the sort of federalism problems the TIA was designed to ameliorate."

The plaintiffs in Hill argued that, under Hibbs, the TIA did not apply because they did not "challenge an assessment imposed on them, but rather assessments imposed on and paid by other persons or entities" — i.e., they were not taxpayers trying to avoid a tax. We disagreed with this reading of Hibbs. We saw "[n]othing in the language of the TIA indicat[ing] that our jurisdiction to hear challenges to state taxes can be turned like a spigot, off when brought by taxpayers challenging their own liabilities and on when brought by third parties challenging the liabilities of others."

We acknowledged that in Hibbs the Court "did point out that TIA cases typically involve challenges brought by state taxpayers seeking to avoid their own state tax liabilities." But we noted that some lower-court cases applied the TIA to suits by third parties who sought to disrupt state tax collection and that the Hibbs Court did not criticize these decisions. We interpreted Hibbs as holding that the "essential problem with the defendant's assertion that the TIA barred the suit . . . lay in the fact that the plaintiff[s] . . . simply did not seek to enjoin the levy or collection of any tax . . . but instead sought to challenge the provision of
a tax credit." The upshot of *Hibbs*, we said, is that "giving away a tax credit is a very different thing than assessing, levying or collecting a tax." The nature of the plaintiff was not the "essential and dispositive distinction under the Supreme Court's teaching in *Hibbs*." Accordingly, we have not interpreted *Hibbs* as holding that the TIA applies only when taxpayers seek to avoid a state tax. Rather, the key question is whether the plaintiff's lawsuit seeks to prevent "the State from exercising its sovereign power to collect . . . revenues." This interpretation adheres to Hibbs's instruction that the primary purpose of the TIA is to "shield[] state tax collections from federal-court restraints."

Contrary to DMA's position, it cannot avoid the TIA merely because it is not a taxpayer challenging tax payment.

b. Notice and reporting obligations

DMA next argues that it seeks to avoid notice and reporting obligations, not a tax. It insists that "[t]he fact that such obligations relate to use tax owed by Colorado consumers does not bring the DMA's suit . . . under the umbrella of the TIA as a suit seeking to enjoin the collection of a state tax."

But the TIA bars more than suits that would enjoin tax collection. It also prohibits federal lawsuits that would "restrain the . . . collection" of a state tax. The issue is whether DMA's attack on Colorado's notice and reporting obligations would "restrain" Colorado's tax collection.

i. Suits that restrain tax collection

In enacting the TIA, Congress chose to prohibit three forms of interference with state tax collection: "enjoin[ing], suspend[ing], or restrain[ing]." Its use of the disjunctive "or" suggests each term has a distinct meaning. The terms "enjoin" and "suspend" suggest entirely arresting tax collection, but "restrain" has a broader ordinary meaning.

Under most definitions, "restrain" means to limit, restrict, or hold back. We accept this ordinary meaning of "restrain," cognizant of the Supreme Court's instruction that the TIA is a broad jurisdictional prohibition.

A lawsuit seeking to enjoin state laws enacted to ensure compliance with and increase use tax collection, like DMA's challenge here, would "restrain" state tax collection. Such a lawsuit, if successful, would limit, restrict, or hold back the state's chosen method of enforcing its tax laws and generating revenue. Federalism concerns, which the TIA seeks to avoid, arise not only when a state tax is challenged in federal court, but also when the means for collecting a state tax are targeted there. The TIA's use of the term "restrain" allows federal courts to weed out lawsuits, such as DMA's, that attempt to undermine state tax collection.

Although DMA does not directly challenge a tax, it contests the way Colorado wishes to collect use tax. This court has said that the TIA "cannot be avoided by an attack on the administration of a tax as opposed to the validity of the tax itself." In making this statement, we agreed with *Czajkowski v. Illinois*, which applied the TIA to a challenge to state cigarette tax enforcement, even though it was "arguable that plaintiffs
[were] only seeking to enjoin the state from using unconstitutional methods and procedures to collect the taxes, rather than the collection of taxes itself."

We acknowledge that DMA's suit is unlike TIA cases in which a plaintiff asks a federal court to invalidate and enjoin a state tax. Even if DMA's constitutional attack on the notice and reporting obligations were successful, Colorado consumers would still owe use taxes by law. But the state-chosen method to secure those taxes would be compromised, curbing Colorado's ability to collect revenue. The inquiry under the TIA is whether DMA's lawsuit would restrain state tax collection. Although DMA's lawsuit differs from the prototypical TIA case, its potential to restrain tax collection triggers the jurisdictional bar.

DMA suggests that the obligations imposed on non-collecting retailers merely "relate to use tax owed by Colorado consumers." We disagree with DMA's characterization and attempt to distance the notice and reporting obligations from the collection of a state tax. Colorado enacted the notice and reporting obligations to increase taxpayers' compliance with use tax laws and thereby increase use tax collection. Even the title of the bill that later became law reflects its tax collection purpose: "An Act Concerning the Collection of Sales and Use Taxes on Sales Made by Out-of-State Retailers." One of the challenged requirements, the annual customer information reports sent to the Department, would aid the Department's auditing of taxpayers, a significant tax collection mechanism. Indeed, the tax collection goal of the notice and reporting requirements is apparent because out-of-state retailers who voluntarily collect tax on Colorado purchases are exempt.

The purposes of the TIA apply both to a lawsuit that would directly enjoin a tax and one that would enjoin a procedure required by the state's tax statutes and regulations that aims to enforce and increase tax collection. Either action interferes with state revenue collection and falls within the "traditional heartland of TIA cases" that dismiss federal lawsuits to protect state coffers.

Other courts have applied the TIA to attacks on tax collection methods, rather than taxes themselves. In Gass v. County of Allegheny, the Third Circuit held that the TIA barred a lawsuit challenging a state tax appeals procedure. Although the appellant argued that its lawsuit did not affect the state's ability to collect tax, the appellate court concluded that the "appeal process is directed to the . . . ultimate goal and responsibility of determining the proper amount of tax to assess" and thus fell within the TIA.

Similarly, the Ninth Circuit has applied the TIA to bar a suit that would have prohibited disclosure of tax information to state taxing authorities. The lawsuit sought to withhold "earnings records and other tax related information to the Idaho and Montana taxing authorities." As here, the taxpayer would have continued to owe tax, but the states would have been deprived of the means to calculate and collect it. The Ninth Circuit said, "[t]he fact that the injunction would restrain assessment indirectly rather than directly does not make the [TIA] inapplicable." The Ninth Circuit has since
explained that whether the TIA applies depends on "the effect of federal litigation on the state's ability to collect revenues, and will only bar the adjudication of a federal constitutional claim in federal court if a judgment for the plaintiffs will hamper a state's ability to raise revenue." We have little problem concluding that DMA's lawsuit would hamper Colorado's ability to raise revenue.

ii. DMA's additional arguments

DMA responds that the Supreme Court has cautioned that the TIA is not a "sweeping congressional direction to prevent federal-court interference with all aspects of state tax administration." We have acknowledged this point, and continue to do so here. But in making this pronouncement, the Supreme Court was distinguishing between federal lawsuits that would not curb state revenue collection, and therefore would not fall within the TIA, and "[f]ederal-court relief [that] . . . [would] reduce the flow of state tax revenue," and thus trigger the TIA. DMA's Commerce Clause claims fall within the latter category.

DMA also cites two federal circuit court cases to argue that our interpretation of the TIA is overly broad: United Parcel Service Inc. v. Flores-Galarza ("UPS"), and Wells v. Malloy.

In UPS, the First Circuit addressed whether the Butler Act, a close relative of the TIA, deprived it of jurisdiction over a challenge to Puerto Rico's interstate package delivery scheme. The Butler Act provides that "[n]o suit for the purpose of restraining the assessment or collection of any tax imposed by the laws of Puerto Rico shall be maintained in the United States District Court for the District of Puerto Rico." UPS challenged Puerto Rico's statutory scheme prohibiting an interstate carrier from delivering a package unless the recipient presented a certificate of excise tax payment. Alternatively, interstate carriers could prepay excise tax and seek reimbursement from package recipients, but this option imposed expensive and burdensome statutory and regulatory obligations.

The First Circuit determined the Butler Act did not bar UPS's action. It reasoned that "UPS sought to enjoin only those provisions . . . that prohibit or interfere with the delivery of packages. UPS did not challenge the amount or validity of the excise tax, nor the authority of the Secretary to assess or collect it." The court also said that Puerto Rico's package "delivery ban targets third parties instead of those who owe the tax." It found that Puerto Rico's laws produced excise tax revenue "indirectly through a more general use of coercive power" and did not create "a system of tax collection within the meaning of the Butler Act."

Even if UPS counsels against applying the TIA here, we decline to follow it. Much of UPS's reasoning conflicts with our own binding case law. For instance, UPS found it important that the plaintiff did "not challenge the amount or validity of the excise tax," but we have said the TIA "cannot be avoided by an attack on the administration of a tax as opposed to the validity of the tax itself." The UPS court also declined to apply the Butler Act.
because Puerto Rico's laws targeted third parties, not taxpayers. But, as discussed above, we recognized in Hill that the TIA can apply to third-party lawsuits that enjoin, suspend, or restrain tax collection. Indeed, much of the reasoning in UPS would have counseled against applying the TIA to the license plate lawsuit in Hill.

DMA also cites Wells v. Malloy. In Wells, the plaintiff sought to enjoin a Vermont provision that required suspension of his driver's license for failure to pay motor vehicle taxes. The plaintiff did not dispute owing taxes. The district court determined the TIA barred the action, but the Second Circuit disagreed.

The court concluded the plaintiff was not seeking to restrain the collection of a tax. It said, "'Collection,' of course, could be read broadly to include anything that a state has determined to be a likely method of securing payment." But the court interpreted "collection" to mean "methods similar to assessment and levy . . . that would produce money or other property directly, rather than indirectly through a more general use of coercive power."

Like Wells, we do not interpret the TIA as applying to any action challenging a state law that could possibly secure tax payment. But here DMA challenges laws enacted to notify consumers of their duty to pay use tax and to garner information on consumer purchases to ensure tax compliance through audits. Its lawsuit targets measures that attempt to ensure tax compliance in the first instance, not sanctions imposed after a taxpayer has admittedly refused to pay taxes. Colorado's laws are not a reactive and punitive "general use of coercive power" to entice tax payment from individuals who admittedly refuse to pay, and we therefore do not think Wells applies here.

Finally, we mention one recent development. After oral argument in this case, this court considered the application of the Anti-Injunction Act ("AIA"), in Hobby Lobby Stores, Inc. v. Sebelius. Using somewhat similar language to the TIA, the AIA states that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." Whereas the TIA protects state tax measures, the AIA "protects the [federal] Government's ability to collect a consistent stream of revenue, by barring litigation to enjoin or otherwise obstruct the collection of taxes."

In Hobby Lobby, two corporations challenged a federal requirement that they provide employees with health insurance coverage for certain contraceptive methods. Failure to comply with the federal requirement exposed the corporations to a "tax" under 26 U.S.C. § 4980. We considered whether the AIA barred the corporations' action because their suit might enjoin a tax on them for non-compliance with the health care coverage requirement.

We explained that the corporations were "not seeking to enjoin the collection of taxes or the execution of any IRS regulation; they [were] seeking to enjoin the enforcement, by whatever method, of one HHS regulation" regarding contraceptive coverage. The "tax [was] just one of many collateral
consequences" of noncompliance with the federal contraceptive-coverage requirement. Moreover, "[t]he statutory scheme made clear that the tax at issue [was] no more than a penalty for violating regulations . . . and the AIA does not apply to the exaction of a purely regulatory tax."

Our position in this appeal is consistent with the analysis in *Hobby Lobby*. The corporations in *Hobby Lobby* challenged a health insurance regulation and a possible penalty for failing to comply with that regulation. To the extent that the penalty constituted a "tax" under the AIA, an issue that this court seemed to doubt in *Hobby Lobby*, it was a "more general use of coercive power," and fell outside the bounds of the AIA.

Here, DMA challenges notice and reporting requirements in Colorado's sales and use tax statutory scheme. These requirements are not a coercive use of power or punitive in nature — they are the state's chosen means of enforcing use tax collection in the first instance. And the state's use tax is indisputably a "tax" under the TIA. The revenue-generating, non-punitive purpose of the notice and reporting obligations places them squarely within the TIA's protection.

DMA's action seeks to restrain the collection of sales and use taxes in Colorado. The state's notice and reporting obligations, while not taxes themselves, were enacted with the sole purpose of increasing use tax collection. Indeed, the obligations for non-collecting retailers are a substitute for requiring these same retailers to collect sales and use taxes at the point of sale, an approach the Colorado legislature deemed foreclosed by the Supreme Court's decision in *Quill*. Having determined that DMA's action falls within the TIA's prohibition on federal lawsuits that would "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law," we proceed to the statute's second element.

2. Does DMA have a plain, speedy, and efficient remedy in Colorado?

For the TIA to apply, DMA must also have a "plain, speedy and efficient remedy . . . in the courts of [Colorado]." This part of the TIA requires that Colorado law offer a "full hearing and judicial determination" on its claims. We must be convinced that Colorado law provides DMA with sufficient process to challenge the notice and reporting requirements.

As previously discussed, Congress intended for the TIA to impose a "broad jurisdictional barrier" that "limit[s] drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." The TIA's "plain, speedy and efficient remedy" provision is therefore interpreted "narrowly" to "be faithful to [this] congressional intent." Our narrow inquiry asks only whether the "state-court remedy . . . meets certain minimal procedural criteria." The TIA does not require that the state provide the best or speediest remedy. And "the likelihood of [a] plaintiff's success in the state court is not a factor . . . when determining whether the jurisdictional prohibition of [the TIA] applies."

DMA does not challenge the process available to it in Colorado. Colorado state
courts can and do grant relief in cases challenging the constitutionality of tax measures. Further, Colorado courts have considered Commerce Clause challenges involving taxes. Circuit courts have routinely said that such available process in state court satisfies the TIA's "plain, speedy and efficient remedy" element.

We are hesitant, however, to stop our analysis there. The Supreme Court in *Hibbs* suggested that the TIA does not refer to general process available in state court. The Court said that a "plain, speedy and efficient remedy" under 28 U.S.C. § 1341 is "not one designed for the universe of plaintiffs who sue the State. Rather, it [is] a remedy tailormade for taxpayers." It then cited to decisions in which taxpayers were allowed to protest taxes in state court after first seeking a refund under state administrative law. Although the *Hibbs* Court was not deciding any issue specifically dealing with the "plain, speedy and efficient remedy" language of the TIA, its brief discussion suggests that the statutory language may contemplate something more than the general availability of a remedy to "the universe of plaintiffs who sue the State."

As discussed earlier, in *Hill v. Kemp*, this court determined that the TIA may bar third-party non-taxpayer lawsuits, despite the *Hibbs* Court's discussion of taxpayer lawsuits. In *Hill*, the plaintiffs had a "plain, speedy and efficient" remedy in state court because Oklahoma tax statutes provided "a general right to protest taxes before the Tax Commission," as well as a right of action to remedy grievances for any state tax law that is contrary to federal law or the Constitution. Thus, in *Hill*, the plaintiffs could seek a remedy under specific state tax laws. This was consistent with *Hibbs* in that these remedies were not available to the universe of plaintiffs suing the state. Accordingly, we address whether Colorado's tax laws similarly provide a more specific remedy to DMA: How can DMA or the remote retailers it represents challenge Colorado's statutory scheme outside of filing an action in state court for injunctive or declaratory relief?

DMA complains that Colorado's laws force remote retailers to choose between obeying the notice and reporting requirements and remitting sales tax to the Department. Much like a taxpayer who seeks to challenge a state tax but must first pay the tax and seek a refund under state law, a remote retailer could choose to remit sales tax and then seek a refund. Colo.Rev.Stat. § 39-26-703(2.5)(a) allows retailers to "file any claim for refund with the executive director of the department of revenue." In pursuing the refund, the retailer could argue that Colorado laws unconstitutionally coerce it to choose between collecting a sales tax and complying with the notice and reporting requirements, the same Commerce Clause argument it brings here. The director then would "promptly examine such claim and . . . make a refund or allow a credit to any [retailer] who establishes that such [retailer] overpaid the tax due." If the retailer is "aggrieved at the final decision," it may seek review in the state district courts.

Another remedy for a remote retailer is to challenge any penalties it incurs for failing to comply with the notice and reporting
obligations. Under Colo. Rev. Stat § 39-21-103, a taxpayer may dispute a tax owed to the Department after receiving a notice of deficiency and may request a hearing. Although this provision discusses tax deficiencies, it also contemplates disputes involving penalties owed to the Department. This provision also contemplates the taxpayer and the executive director agreeing that "a question of law arising under the United States or Colorado constitutions" is implicated in the dispute, bypassing a hearing, and going "directly to the district court."

We are satisfied that Colorado provides avenues for remote retailers to Challenge the scheme allegedly forcing them to choose between collecting sales tax and complying with the notice and reporting requirements. Colorado's administrative remedies provide for hearings and appeals to state court, as well as ultimate review in the United States Supreme Court. Whether DMA or a remote retailer it represents files a similar lawsuit in state court seeking injunctive and declaratory relief, or whether it follows Colorado's administrative tax procedures, a plain, speedy, and efficient remedy is available in Colorado.

III. CONCLUSION

The TIA divested the district court of jurisdiction over DMA's Commerce Clause claims, and we therefore have no jurisdiction to reach the merits of this appeal. We remand for the district court to dismiss DMA's Commerce Clause claims for lack of jurisdiction, dissolve the permanent injunction entered against the Department, and take further appropriate action consistent with this opinion.
The Supreme Court on Tuesday agreed to hear a case challenging Colorado’s so-called Amazon tax law, taking up the issue of whether federal judges have the power to decide whether states may impose reporting requirements on out-of-state retailers as part of their tax laws. The closely watched case gives Supreme Court justices the chance to clarify the scope of the Tax Injunction Act’s jurisdiction. The TIA, in general, prevents federal courts from interfering with state tax collection regimes. The Direct Marketing Association, a trade association of direct-marketing retailers, asked the high court in February to review the Tenth Circuit’s use of the law.

“Jurisdictional cases are always important because it’s essential for the appellate court system, and ultimately the Supreme Court, to indicate when you can go to federal court,” association attorney George S. Isaacson of Brann & Isaacson said in March. “And when you have [a court] expanding the scope of the TIA without any clear guidance, it’s unsettling to businesses who want to be able to have certainty in pursuing claims in federal court.”

The dispute stems from a 2010 Colorado law requiring remote retailers selling to in-state customers to comply with a number of notice and reporting obligations intended to beef up the state's use-tax collections.

The DMA filed a complaint challenging the constitutionality of Colorado’s law shortly after it was adopted, arguing that the new regulations, which don't apply to retailers located in Colorado, discriminate against out-of-state retailers. U.S. District Judge Robert E. Blackburn agreed, ruling that Colorado's reporting requirements strained interstate commerce in violation of the U.S. Constitution's Commerce Clause.

But, on appeal, the Tenth Circuit overturned the decision on procedural grounds. The appeals court said Judge Blackburn was precluded from considering the merits of DMA's complaint because the district court lacked jurisdiction under the TIA.

“The TIA divested the district court of jurisdiction over DMA’s Commerce Clause claims, and we therefore have no jurisdiction to reach the merits of this appeal,” the Tenth Circuit said. The appeals court, citing a lack of jurisdiction, directed Judge Blackburn to throw out DMA's Commerce Clause claims.

Now before the Supreme Court, the DMA says in its petition that the constitutional question presented in its complaint does not fall under the purview of the TIA because it is not challenging Colorado's tax per se. Instead, DMA argues, its challenge avoids the tax question and targets only the state law's reporting requirements.
“It is the nontax, notice and reporting obligations imposed on noncollecting retailers under the act that place the DMA’s challenge outside the scope of the TIA,” DMA says in its petition.

Isaacson said jurisdictional questions over the TIA were not originally raised in the state’s appeal. He said the appeals court decision conflicts with prior rulings in the First and Second circuits.

Colorado’s regulations require three things: First, out-of-state retailers must send “transactional notices” to their Colorado buyers notifying them that they must file state sales- or use-tax returns declaring items purchased from those retailers.

Second, an out-of-state retailer must send an annual report to each Colorado buyer itemizing the total amount of purchases the buyer made from that particular retailer. The report, known as an annual purchase summary, must also remind the buyer that he or she is responsible for filing a Colorado sales or use tax return.

Third, the law requires out-of-state retailers to file an annual report with the Colorado Department of Revenue that shows the total amount of purchases Colorado buyers made during the preceding calendar year, known as customer information reports.

Retailers are fined if they fail to comply with the requirements — $5 per transactional notice violation, capped at $50,000 per retailer; $10 per violation of the annual purchase summary requirement, capped at $100,000 per retailer; and $10 per violation of the customer information report requirement, also capped at $100,000 per retailer.

DMA is represented by George S. Isaacson and Matthew P. Schaefer of Brann & Isaacson LLP.

The case is Direct Marketing Association v. Brohl et al., case number 13-1032, in the Supreme Court of the United States.
The U.S. Supreme Court July 1 agreed to hear a case challenging a Colorado law requiring out-of-state retailers to report to the state the names, addresses and total annual purchases of their Colorado customers.

The court July 1 said it will review a case brought by the Direct Marketing Association (DMA), which seeks to overturn a ruling by the U.S. Court of Appeals for the Tenth Circuit that held that the Tax Injunction Act (TIA) barred federal court jurisdiction to enjoin the enforcement of the Colorado law.

“We are pleased that the Supreme Court has agree to hear this important case,” Peggy Hudson, the DMA's senior vice president of government affairs, said in a July 1 DMA statement. “DMA began this fight four years ago with the goal of protecting consumer privacy by safeguarding businesses from being forced to divulge their customers' purchase history to the state of Colorado. Along the way, the fight has broadened to encompass not only issues of privacy, but also fundamental constitutional questions about access to federal courts.”

The DMA’s lead attorney, George S. Isaacson of Brann & Isaacson in Lewiston, Maine, told Bloomberg BNA July 1 that “the DMA is pleased the Supreme Court has decided to address the scope of the TIA.” He said the case involves constitutional questions that are important to retailers who offer their products in multiple states.

Disputes over the release of customer purchase information from online retailers, such as Amazon.com, haven't been limited to Colorado. North Carolina's Department of Tax Revenue was one of the first state tax agencies to face legal challenges over demands for Web customer data.

**Court Challenges**

The DMA initially brought its lawsuit in the U.S. District Court for the District of Colorado, challenging a reporting requirement imposed on out-of-state vendors that don't collect and remit state sales and use taxes. The law requires those vendors to provide their customers' purchase history information to the state, the DMA explained in its statement.

“In the lawsuit, DMA contends that the Colorado law constitutes an unprecedented invasion of consumer privacy and unfairly discriminates against interstate commerce by targeting solely out-of-state merchants,” the DMA said.

In 2012, that court ruled in favor of the DMA, calling the “Amazon law” unconstitutional for violating the dormant
The court imposed a permanent injunction preventing the state from executing the law.

The U.S. Court of Appeals for the Tenth Circuit reversed the decision and dismissed the case, citing the lack of federal jurisdiction due to the TIA, 28 U.S.C. § 1341. An attempt by the DMA to have the case reconsidered en banc was denied.

After failing to get a full review from the Tenth Circuit, the case was removed to Colorado state court where the DMA won a preliminary injunction. Briefs for summary judgment in that case are due the week of July 7, Isaacson and Christopher Oswald, the DMA’s vice president of state affairs, told Bloomberg BNA July 1.

**Notice, Reporting Requirements**

Oswald said the main issues in the case are the notice and reporting aspects of the Colorado law. “Those requirements are separate and apart from the taxation element,” he said.

Oswald noted that the Supreme Court's decision could have implications beyond Colorado, particularly in states considering similar schemes such as Michigan and Colorado.

Should the Supreme Court rule in the DMA’s favor, Oswald said he feels confident about the DMA’s chances of succeeding on the merits of the case.

“The underlying question of whether the notice and reporting requirements are constitutional or not is something we won on in federal district court. We also won a preliminary injunction in state court. So we feel pretty confident,” he said.

George S. Isaacson and Matthew P. Schaefer of Brann & Isaacson, in Lewiston, Maine, represented the DMA. John Suthers, Daniel D. Domenico, Melanie J. Snyder and Grant to Sullivan of the Colorado State Attorney General's Office, in Denver, represented the director of the Colorado Department of Revenue.
“Tenth Circuit: Tax Injunction Act Precluded Federal Jurisdiction in Colorado’s E-Commerce Use Tax Reporting Requirements Case”

CBA Legal Connection
Ellen Buckley
August 29, 2013

The Tenth Circuit Court of Appeals published its opinion in Direct Marketing Ass’n v. Brohl on Tuesday, August 20 2013.

Colorado imposes a 2.9% use tax on tangible goods stored, used, or consumed in the state when no sales tax has been paid. Because the dormant Commerce Clause prohibits Colorado from forcing retailers with no in-state physical presence to collect and remit taxes on sales to Colorado consumers, the state requires its residents to report and pay use taxes to the Department with their income tax returns. In 2010 the Colorado legislature enacted statutory requirements for non-collecting retailers. The statute and its implementing regulations impose three principal obligations on non-collecting retailers whose gross sales in Colorado exceed $100,000: they must (1) provide transactional notices to Colorado purchasers, (2) send annual purchase summaries to Colorado customers, and (3) annually report Colorado purchaser information to the Department.

The Direct Marketing Association (DMA) sued the Department of Revenue’s executive director, challenging the constitutionality of the state’s new notice and reporting requirements. The district court concluded that Colorado’s requirements for non-collecting retailers discriminated against and placed undue burdens on interstate commerce, in violation of the Commerce Clause and entered a permanent injunction prohibiting enforcement of the state requirements. The Department appealed.

The Tenth Circuit did not reach the Commerce Clause issue on appeal because it held that the Tax Injunction Act (TIA) precluded federal jurisdiction over DMA’s claims. The TIA provides that “district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.”

The DMA argued that it sought to avoid notice and reporting obligations, not a tax, so the TIA did not apply. The court disagreed. “The purposes of the TIA apply both to a lawsuit that would directly enjoin a tax and one that would enjoin a procedure required by the state’s tax statutes and regulations that aims to enforce and increase tax collection.” The court also found that a plain, speedy and efficient remedy is available to retailers subject to the Colorado law.

The court remanded to the district court to dismiss DMA’s Commerce Clause claims for lack of jurisdiction and to dissolve the permanent injunction.

Relator brought qui tam action against government contractor under the False Claims Act (FCA), alleging the contractor falsely billed the United States for services performed in Iraq. The United States District Court for the Eastern District of Virginia, James C. Cacheris, Senior District Judge, dismissed the complaint. Relator appealed.

Questions Presented: (1) Whether the Wartime Suspension of Limitations Act – a criminal code provision that tolls the statute of limitations for “any offense” involving fraud against the government “[w]hen the United States is at war,” and which this Court has instructed must be “narrowly construed” in favor of repose – applies to claims of civil fraud brought by private relators, and is triggered without a formal declaration of war, in a manner that leads to indefinite tolling; and (2) whether, contrary to the conclusion of numerous courts, the False Claims Act’s so-called “first-to-file” bar – which creates a race to the courthouse to reward relators who promptly disclose fraud against the government, while prohibiting repetitive, parasitic claims – functions as a “one case-at-a-time” rule allowing an infinite series of duplicative claims so long as no prior claim is pending at the time of filing.


United States Court of Appeals, Fourth Circuit

Decided on March 18, 2013

[Excerpt; some footnotes and citations omitted.]

FLOYD, Circuit Judge.

Reversed and remanded by published opinion. Judge FLOYD wrote the majority opinion, in which Judge WYNN joined. Judge WYNN wrote a separate concurring opinion. Judge AGEE wrote a separate opinion concurring in part and dissenting in part.

Appellant Benjamin Carter appeals the district court's dismissal of his complaint with prejudice. The matter was initiated upon Carter's filing of a qui tam lawsuit under the False Claims Act (FCA). The subject matter underlying this case involves Appellees' — Halliburton Company; KBR, Inc.; Kellogg Brown & Root Services, Inc.;
and Service Employees International, Inc. (collectively KBR) — alleged fraudulent billing of the United States for services provided to the military forces serving in Iraq. The district court concluded that it lacked subject matter jurisdiction over Carter's claims because of the False Claims Act's first-to-file bar. The district court also held that Carter's complaint had been filed beyond the six-year statute of limitations in the FCA and was not tolled by the Wartime Suspension of Limitations Act (WSLA), which the court ruled does not apply to non-intervened qui tam cases. Accordingly, the district court dismissed Carter's complaint with prejudice. Because we conclude that the district court had subject matter jurisdiction and find that the WSLA applies to this action, we reverse. Further, because it may be appropriate for the district court to make factual findings to consider the public disclosure claim urged by KBR, we remand so the district court can consider this issue.

I.

In his complaint, Carter brings a qui tam action under the False Claims Act. The FCA allows the United States to bring suit to recover funds and also allows, through the Act's qui tam provisions, for a private plaintiff (relator) to sue in place of the government and keep a share of the proceeds. Carter alleges that KBR falsely billed the United States for services performed in Iraq. Specifically, Carter alleges that KBR "knowingly made, used, or caused to be made or used, false records or statements to get false or fraudulent claims paid or approved by the Government" in violation of 31 U.S.C. § 3729(a)(2).

KBR provided logistical services to the United States military in Iraq under a government contract. Carter worked for KBR as a reverse osmosis water purification unit (ROWPU) operator at two camps in Iraq from mid-January 2005 until April 2005. Carter was hired to test and purify water for the troops in Iraq. Carter claims that KBR was in fact not purifying water during the time period but was repeatedly misrepresenting to the United States that it was. Carter submits that water purification did not actually begin until May 2005. Further, Carter maintains that he and his fellow employees were instructed to submit time sheets for twelve-hour days for work that they performed on ROWPU functions. During this time, Carter states that he was actually not working any hours on ROWPU functions. Carter also contends as part of an overall scheme by KBR to overbill the government for labor charges, that all trade employees were required to submit time sheets totaling exactly twelve hours per day and eighty-four hours per week and that it was "routine practice" of the employees to do so regardless of actual hours worked. As a result, according to Carter, the United States paid KBR for work not actually performed.

Carter filed his original complaint under seal on February 1, 2006, in the United States District Court for the Central District of California. After over two years of
investigation into the matter, the action was unsealed in May 2008. Shortly thereafter, the case was transferred to the Eastern District of Virginia in October 2008, at which point Carter amended his complaint. The district court dismissed Carter's first amended complaint without prejudice in January 2009 for failure to plead fraud with particularity. Carter then amended his complaint for a second time and refiled his complaint in January 2009 (Carter 2009). KBR then moved to dismiss Carter's second amended complaint under Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure, which the district court granted in part. The district court, however, refused to dismiss counts 1 and 4. Count 1 alleged a scheme by KBR to submit fraudulent claims for payment to the government, and count 4 alleged fraudulent statements knowingly made to the government to receive claims for payment. At this point, KBR answered the remaining allegations and the case proceeded through discovery, which closed in March 2010.

In March 2010, one month before the scheduled trial date, the parties were contacted by the United States Department of Justice, who informed them of the existence of a False Claims Act case containing similar allegations filed under seal in December 2005, in the United States District Court for the Central District of California. Thorpe also alleges that KBR's standard operating procedure was billing twelve hours per day, without regard to the actual hours worked to perpetuate a scheme to overbill the government. In April 2010, KBR filed a motion to dismiss Carter 2009, arguing that Thorpe constituted a "related" action under FCA § 3730(b)(5). In response, Carter argued that Thorpe was materially different from his case because he focused on KBR's alleged fraudulent misrepresentation to the government that KBR was actually performing water services for which it was submitting bills.

The district court rejected Carter's characterization, reasoning that he must show that KBR employees were reporting hours that they did not work and the fact that KBR was not performing water services is merely evidence that the time sheets were false. The district court dismissed Carter 2009 without prejudice on May 10, 2010. Carter appealed the dismissal on July 13, 2010.

Thereafter, the United States District Court for the Central District of California dismissed the Thorpe action on July 30, 2010. In response, Carter refiled his complaint (Carter 2010) in the United States District Court for the Eastern District of Virginia while his appeal was still pending. When Carter refiled his complaint, he also sought to dismiss his appeal in the 2009 action. This Court granted Carter's motion to dismiss his appeal on February 14, 2011. Meanwhile, Carter 2010 proceeded in the district court and, on May 24, 2011, the district court dismissed Carter's complaint without prejudice, on the grounds that Carter had filed Carter 2010 while Carter 2009 was still pending on appeal, thereby creating his own jurisdictional bar under the FCA's first-to-file provision. Carter chose not to appeal this ruling.

However, Carter refiled his complaint (Carter 2011) on June 2, 2011. The district
The court unsealed the complaint on August 24, 2011. The complaint in this case is identical to the earlier 2010 complaint as well the second amended complaint filed in 2009. After the complaint was unsealed, KBR moved to dismiss the action, arguing that the complaint was barred by two related actions, that the case was time barred, and that the case was barred by the public disclosure provision of the FCA.

At the time Carter 2011 was filed, two allegedly related cases were pending: United States ex rel. Duprey, and another action — that is under seal — filed in Texas in 2007. Duprey and the Texas action allege that KBR "knowingly presented, or caused to be presented, to an officer or employee of the United States Government, false or fraudulent claims for payment or approval in violation of 31 U.S.C. § 3729(a)(1)." Since at least March 2003, KBR provided shipping and transportation support in Iraq for the United States military. The Duprey relator was employed by KBR as a truck driver in Iraq from March 27, 2005, to January 15, 2006. The Texas relators were also truck drivers in Iraq, and at least one relator was present in Iraq during the period of September 2003 to March 15, 2004. Both complaints allege substantially similar claims, namely that KBR had a policy that its drivers enter time sheets reflecting a twelve hour workday and an eighty-four hour work week, without regard to actual hours worked. The relators alleged that this practice was widespread throughout KBR's operations in Iraq and elsewhere. Duprey was subsequently voluntarily dismissed in October 2011, and the Texas action was voluntarily dismissed in March 2012.

The district court granted KBR's motion and dismissed the complaint with prejudice on November 29, 2011, ruling that the case was related to Duprey and the Texas action. The court also found that Duprey was "pending" for purposes of the first-to-file bar, because it had not been dismissed at the time Carter 2011 was filed. The court considered whether the Texas action was also "pending" as to bar Carter 2011, but ultimately concluded that it need not decide the issue because at least one case — Duprey — was pending. The district court also held that Carter 2011 had been filed beyond the FCA's six-year statute of limitations and would be time barred should it be refiled. Because of this reason, the court dismissed the case with prejudice. The district court further held that Carter's action was not tolled by the WSLA. The district court held that the WSLA does not apply to claims under the FCA brought by private relators. Finding ample grounds to dismiss the action, the district court did not consider whether the complaint was barred by the public disclosure provision of the FCA. Carter timely appealed. We have jurisdiction pursuant to 28 U.S.C. § 1291.

II.

We review de novo the district court's legal rulings, such as its granting of KBR's motion to dismiss. To the extent that the decisions below involved legal conclusions based upon factual determinations, we review the factual findings for clear error, viewing the evidence in the light most favorable to Carter.

III.
We first address Carter's contention that the WSLA tolls his action and therefore, that his claims are not time barred under the FCA.

A.

First, as a general matter, qui tarn actions must be brought within six years after the date on which the alleged violation occurred. The WSLA was enacted in 1942 to extend the time for prosecution to bring charges relating to criminal fraud offenses against the United States during times of war. When enacted, the law applied to "offenses involving the defrauding or attempts to defraud the United States . . . and now indictable under any existing statutes." When amended in 1944, the phrase "now indictable" was deleted. The WSLA was later codified, and is now to be used whenever the country is at war.

The Fifth Circuit has determined that the WSLA has three components: "(1) a triggering clause ("When the United States is at war the running of [the applicable statute of limitations] shall be suspended . . . .") (2) a suspension period ('three years'), and (3) a termination clause ('suspended until . . . after the termination of hostilities as proclaimed by the President or by a concurrent resolution of Congress.')." The Supreme Court has held that the WSLA applies only to offenses committed after the triggering clause and before the termination of hostilities. The running of the limitations period then begins when hostilities are terminated.

Prior to October 4, 2008, the WSLA provided:

When the United States is at war the running of any statute of limitations applicable to any offense (1) involving fraud or attempted fraud against the United States . . . shall be suspended until three years after the termination of hostilities as proclaimed by the President or by a concurrent resolution of Congress.

In 2008, the Wartime Enforcement of Fraud Act (WEFA) amended the WSLA to expand its times of operation to "[w]hen the United States is at war or Congress has enacted specific authorization for the use of the Armed Forces, as described in section 5(b) of the War Powers Resolution (50 U.S.C. 1544(b))." Additionally, the suspension period was extended until "5 years after the termination of hostilities as proclaimed by a Presidential proclamation, with notice to Congress, or by a concurrent resolution of Congress."

Courts are in disagreement as to which version of the WSLA applies to offenses that occurred before the amendments of 2008. Additionally, courts are in conflict as to whether the pre-amendment WSLA requires a formal declaration of war or whether the authorized use of military force shall suffice.

B.

Carter contends that the conflict in Iraq in 2005 is sufficient to trigger WSLA's "at war" status under either version of the WSLA. KBR however, urges us not to apply the post-amendment WSLA because it believes that the post-amendment WSLA implicates its constitutional due process
rights in that the Act may allow a statute of limitations to run indefinitely.

The question presented is the meaning of "at war" as it appears in the WSLA. As with all questions of statutory construction, we begin by examining the statute's language. "[W]hen a statute speaks with clarity to an issue[,] judicial inquiry into the statute's meaning, in all but the most extraordinary circumstance, is finished." In interpreting a statute we "must presume that a legislature says in a statute what it means and means in a statute what it says there."

Although the meaning of "at war" may appear unambiguous at first glance, its meaning in the context of the WSLA is not so clear. As the Supreme Court has noted, "Congress in drafting laws may decide that the Nation may be at war for one purpose, and at peace for another." Therefore, we must determine what Congress meant by "at war" in the context of the WSLA.

As an initial matter, we find it unnecessary to decide which version of the WSLA applies because we find that the Act does not require a formal declaration of war. Therefore, under either version of the Act, the United States was at war when the acts at issue occurred. We find that the Act does not require a formal declaration of war for several reasons. First, had Congress intended the phrase "at war" to encompass only declared wars, it could have written the limitation of "declared war" into the Act as it has in numerous statutes.

Next, we believe that requiring a declared war would be an unduly formalistic approach that ignores the realities of today, where the United States engages in massive military campaigns resulting in enormous expense and widespread bloodshed without declaring a formal war. In fact, the United States has not declared war since World War II. However, there have been extensive military engagements in Vietnam, Korea, Kosovo, Afghanistan, and twice in Iraq. Indeed, the Supreme Court has found that the laws of war apply to non-declared wars, for example the war in Afghanistan. Surely these circumstances result in situations in which fraud can easily be perpetuated against the United States just as much as a formally declared war. The purpose of the WSLA — to combat fraud at times when the United States may not be able to act as quickly because it is engaged in "war" — would be thwarted were we to find that the United States must be involved in a declared war for the Act to apply.

With these principles in mind, we now address the specific conflict in Iraq. On October 11, 2002, Congress authorized the President to use military force to "defend the national security of the United States against the continuing threat posed by Iraq" and "enforce all relevant United Nations Security Council resolutions regarding Iraq." Although not a formal recognition of war, the AUMF signaled Congress's recognition of the President's power to enter into armed hostilities. Based on the foregoing analysis, we find that the United States was "at war" in Iraq from the date of the AUMF issued by Congress on October 11, 2002.

We now turn to when — and if — the hostilities in Iraq terminated. The Fifth Circuit recently considered this issue in
Pfluger. There the court determined that termination clause of the WSLA required compliance with the formal requirements set out in the clause because the language of the clause was plain and unambiguous. We agree. The pre-amendment and post-amendment WSLA both specify that termination shall not occur until the Act's formalities have been met. In the pre-amendment WSLA, termination occurs when "proclaimed by the President or by a concurrent resolution by Congress." In the post-amendment WSLA, termination happens when "proclaimed by a Presidential proclamation, with notice to Congress, or by a concurrent resolution of Congress." Neither Congress nor the President had met the formal requirements of the Act for terminating the period of suspension when the claims at issue were presented for payment. We therefore conclude that the United States was at war during the relevant time period for purposes of the WSLA.

C.

KBR next argues that the WSLA does not apply to Carter's claims because the WSLA by its plain terms applies only to criminal cases. KBR bases its argument on the language in the statute that states it applies to "offense[s] involving fraud" and reasons that "offense" ordinarily means only crimes. Resolution of this issue requires us to interpret the meaning of "offense" as used in the WSLA.

In Dugan & McNamara, the court examined both the legislative history of the Act and the meaning of "offense." The court reasoned that the term "offense" in the 1942 version referred only to criminal penalties. However, when amended in 1944, the phrase "now indictable" was deleted. The WSLA was then applicable to all actions involving fraud against the United States. Further, all but one court, United States v. Weaver, to have considered the issue of whether the WSLA applies to civil claims have found that it applies.

Had Congress intended for "offense" to apply only to criminal offenses, it could have done so by not deleting the words "now indictable" or it could have replaced that phrase with similar wording. However, Congress did not include any limiting language and it is our opinion that in failing to do so it chose for the Act to apply to all offenses involving fraud against the United States. Therefore, because we find the text of the WSLA, the 1944 amendments, and the legislative history persuasive, we find that the WSLA applies to civil claims.

D.

The district court found that even if the WSLA was applicable to civil cases, it remains inapplicable to actions where the United States is not a party. The district court relied on this Court's decision in United States ex rel Sanders v. North American Bus Industries Inc., for support that the WSLA includes actions brought only by the United States. This Court held in Sanders that 31 U.S.C. § 3731(b)(2), a special statutory extension of the FCA's statute of limitations, was available only to the government. Sanders's reasoning is further supported by the fact that the FCA has a statute of limitations that applies specifically to relators. The limitations period in § 3731(b)(2) starts when the
government knows or should know of "facts material to the right of action." The court reasoned:

This language makes perfect sense when referring to an action brought by the government: the limitations period is based on the government's knowledge of facts material to the right of action" because that particular knowledge notifies the government that it has an actionable FCA claim. But applying the statute's language to a relator's action makes no sense whatsoever.

Unlike in Sanders, whether the suit is brought by the United States or a relator is irrelevant to this case because the suspension of limitations in the WSLA depends upon whether the country is at war and not who brings the case. As such the district court's reliance on Sanders was misguided.

Courts are "authorized to deviate from the literal language of a statute only if the plain language would lead to absurd results, or if such an interpretation would defeat the intent of Congress." Sanders follows this logic, but this principle does not exclude relator-initiated actions from the ambit of the WSLA. Including such actions does not lead to "absurd results" nor "defeat the intent of Congress." In fact, including civil claims furthers the WSLA's purpose: to root out fraud against the United States during times of war. The district court's reasoning for relying on Sanders was that if the WSLA applied to a relator's claims this would "allow fraud [claims] to extend perhaps indefinitely." This is incorrect. The WSLA tolls the applicable period for a specified and bounded time while the country is at war. By offering this rationale, it appears the court was critiquing the purpose of the WSLA itself and not providing a valid basis for excluding relator-initiated claims from the WSLA. Accordingly, we are unpersuaded that relator-initiated claims are excluded from the ambit of the WSLA. Thus, Carter's action is not time barred.

IV.

We next consider KBR's argument that the FCA's first-to-file bar prohibits Carter's case from proceeding.

A.

The FCA prescribes penalties for claims submitted to the government that are known to be false. While encouraging citizens to act as whistleblowers, the Act also seeks to prevent parasitic lawsuits based on previously disclosed fraud. To reconcile these conflicting goals, the FCA has placed jurisdictional limits on its qui tain provisions, including § 3730(b)(5)'s first-to-file bar and § 3730(e)(4)'s public disclosure provision.

Under the first-to-file bar, if Carter's claims had been previously filed by another relator, then the district court lacked subject matter jurisdiction. By the same token, the public disclosure bar prevents a relator from bringing an action if the matters therein have already been made public knowledge, except if the person is an original source of the information. Although the provisions promote the same goals, they have different requirements. Here the district court ruled on the firstto-file bar and did not consider
the public disclosure bar. Because of this, we begin with the first-to-file bar.

B.

KBR argues that Duprey and the Texas action are related actions that deprive this Court of jurisdiction under the first-to-file bar. This Court has described the first-to-file bar as an absolute, unambiguous exception-free rule. Therefore, whoever wins the race to the courthouse prevails and the other case must be dismissed. The text of the relevant section provides that "[w]hen a person brings an action under [the FCA], no person other than the Government may intervene or bring a related action based on the facts underlying the pending action." Section 3730(b)(5) is jurisdictional and if an action is later filed that is based on the facts underlying the pending case, the court must dismiss the later case for lack of jurisdiction.

In determining whether a complaint is similar enough as to be caught by the first-to-file bar, courts have applied variations of a common approach. Although the approaches vary, courts have almost uniformly rejected an "identical facts" test on the ground that the provision refers to a "related" action rather than an "identical" action. The courts also agree that differences in specifics — such as geographic location or added facts — will not save a subsequent case. The Third, Fifth, Sixth, Ninth, Tenth, and D.C. circuits have all adopted a "same material elements test."

Under this test, a later suit is barred if it is based upon the "same material elements of fraud" as the earlier suit, even though the subsequent suit may "incorporate somewhat different details." "[T]he test prevents the less vigilant whistle-blower from using insignificant factual variations to allege what is essentially the same fraudulent scheme already made known to the government." We find our sister circuits' reasoning persuasive, and we join these circuits in adopting the "material elements test."

C.

We shall now apply the material elements test to determine whether Carter's action is barred by either Duprey or the Texas action. The allegations in Duprey, the Texas action, and herein are substantially similar. All allege that KBR had a systematic practice of overbilling the government for hours worked by their employees. The employees were instructed to complete their time sheets without regard to the number of hours that were actually worked. These allegations of fraud provide the government with enough knowledge of essential facts of the scheme to discover related fraud. The government would likely investigate billing practices across the company, because Duprey notes that the official national policy was to bill correctly but that the employees were consistently instructed not to do so.

Carter seeks to distinguish his action by pointing out that the other relators worked in different divisions and were truck drivers, whereas he was a ROWPU employee. We are unpersuaded that these distinctions are material. Duprey and the Texas action both allege a broad scheme that encompasses the time and location of Carter's action. Even though the fraud did occur via different types of employees and in different
divisions, this is insufficient to demonstrate that the scheme Carter alleges is different from the one Duprey and the Texas relators allege. As the Fifth Circuit noted, "a relator cannot avoid § 3730(b)(5)'s first-to-file bar by simply adding factual details or geographic location to the essential or material elements of a fraud claim. . . ." Here the fraud alleged — submission of false time sheets in support of claims for false payment — is the same in all of the complaints. Thus, Section 3730(b)(5)'s goal of preventing parasitic qui tam lawsuits would not be furthered if all three actions were allowed to proceed on the same essential claims.

D.

Carter argues that regardless of the relatedness of his complaint to the other cases, the other cases cannot continue to have a preclusive effect on his action. Carter argues that because the Duprey and Texas action have been dismissed neither can be deemed a "pending action" under § 3730(b)(5).

Following the plain language of the first-to-file bar, Carter's action will be barred by Duprey or the Texas action if either case was pending when Carter filed suit. The Duprey action was filed in 2007, and voluntarily dismissed in October 2011, after the relator failed to serve the complaint on the defendants. The Texas action was filed in 2007 and voluntarily dismissed in March 2012, when the government declined to intervene. Therefore, both actions were pending when Carter filed his complaint on June 2, 2011. Because we look at the facts as they existed when the claim was brought to determine whether an action is barred by the first-to-file bar, we conclude that Carter's claims are barred by the Duprey and Texas actions. However, this does not end our inquiry.

Carter alleges that the district court erred when it dismissed his complaint with prejudice on the ground that his action was forever barred by the Duprey action. In United States ex rel. Chovanec v. Apria Healthcare Group, Inc., the Seventh Circuit reviewed a complaint that was dismissed with prejudice because of a pending case. The court reasoned that once the initial complaint was no longer pending, the bar of § 3730(b)(5) was inapplicable and Chovanec was "entitled to file a new qui tarn complaint." However, if a case is brought while the original case is pending it must be dismissed "rather than left on ice." Although the doctrine of claim preclusion may prevent the filing of subsequent cases, § 3730(b)(5) does not. This is especially true when the original case is dismissed on reasons other than the merits or dismissed without prejudice. Because Chovanec was entitled to file a new complaint, the proceeding should have been dismissed without prejudice.

Similarly the Tenth Circuit has explained why an action that is no longer pending cannot have a preclusive effect for all future claims. The court reasoned, "if that prior claim is no longer pending, the first-to-file bar no longer applies." "The'pending' requirement much more effectively vindicates the goal of encouraging relators to file; it protects the potential award of a relator while his claim remains viable, but,
when he drops his action another relator . . . may pursue his own."

We agree that once a case is no longer pending the first-to-file bar does not stop a relator from filing a related case. In this case, both of the original actions have been dismissed. Because of this, the first-to-file bar does not preclude Carter from filing an action. The first-to-file bar allows a plaintiff to bring a claim later; this is precisely what a dismissal without prejudice allows a plaintiff to do as well. Therefore, Carter's only impediment at the moment is the district court's dismissal with prejudice. And, as we have already concluded the district court erred in dismissing Carter's complaint with prejudice.

V.

KBR argues that this Court should affirm the dismissal of Carter's complaint on the alternative ground of the FCA's public disclosure provision. As noted previously, the public disclosure bar removes subject matter jurisdiction for FCA claims that are based upon matters that have been disclosed publicly, unless the relator was the original source of the allegations. KBR alleges that Carter was not the original source of the information, and that he gathered the information from another KBR employee. The district did not reach this argument, having found grounds for dismissal elsewhere. We decline to address this issue for the first time on appeal. Because the district court should have the opportunity in the first instance to address the facts relevant to public disclosure, we remand this issue to the district court.

VI.

For the foregoing reasons we reverse the district court's dismissal of Carter's complaint. Rather than address the alternative ground of the public disclosure bar for the first time on appeal, we remand this issue to the district court for further consideration.

REVERSED AND REMANDED

WYNN, Circuit Judge, concurring:

I fully concur in the fine majority opinion. I write separately to address what appears to be the heart of the dissent's objections: that applying the Wartime Suspension of Limitations Act, to the False Claims Act, actions in which the United States is not plaintiff or intervenor is unwise because doing so is contrary to the policy of strictly construing statutes of limitations and the goals of the False Claims Act. In particular, the dissent expresses concern that our decision will allow the False Claims Act limitations period to "extend indefinitely" and, consequently, will incentivize private plaintiffs to delay filing their claims to maximize their potential recovery. Because it is not our place to second-guess Congress's clearly expressed policy decisions, I respectfully disagree with the dissent.

When interpreting a federal statute, the "cardinal rule . . . is that the intent of [Congress] is to be given effect." Typically, we ascertain Congressional intent from the plain language of the statute. If the plain language of the statute unambiguously expresses Congress's intent, our inquiry
comes to an end, even if we disagree with the policy embraced by the statutory language. For, as the Supreme Court has explained,

Our individual appraisal of the wisdom or unwisdom of a particular course consciously selected is to be put aside in the process of interpreting a statute. Once the meaning of an enactment is discerned and its constitutionality determined, the judicial process comes to an end. We do not sit as a committee of review, nor are we vested with the power of veto.

Here, as the majority correctly concludes and the dissent tacitly acknowledges, the plain language of the Wartime Suspension of Limitations Act extends the limitation period for "any offense" of fraud against the United States during a time of war. No doubt recognizing that it is not our role to question Congress's clearly expressed policy determinations, the dissent relies on strained readings of the Wartime Suspension of Limitations Act and our precedent in an attempt to argue that, under the plain language of the Wartime Suspension of Limitations Act and our precedent in an attempt to argue that, under the plain language of the Wartime Suspension of Limitations Act, the term "any offense" does not encompass False Claims Act actions in which the government is not a party.

First, the dissent appeals to our decision in United States ex rel. Sanders v. North American Bus Industries, Inc., in which we held that the False Claims Act limitations period tolling provision, does not apply to False Claims Act actions in which the government is not a party. Section 3731(b)(2) provides that the standard six-year False Claims Act limitations may be tolled until "no more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the official of the United States charged with responsibility to act in the circumstances." In Sanders, we reasoned that Section 3731(b)(2) does not toll the limitations period for private False Claims Act actions because it would make little sense to have a suit's limitations period turn on the knowledge of an entity that is not party to the action.

The majority opinion correctly notes that Sanders is inapposite because it involved an entirely different statute, which includes express language that supports distinguishing between False Claims Act actions where the government is and is not a party. Nevertheless, the dissent tries to analogize the Wartime Suspension of Limitations Act to Section 3731(b)(2), which was at issue in Sanders, by asserting that federal government conduct controls the limitations periods set out in both statutes. In particular, the dissent notes that

[b]y the terms of the [Wartime Suspension of Limitations Act], the government is solely entitled to invoke and terminate the tolling provisions of the statute. . . . The private qui tarn plaintiff has no connection with these decisions and it seems odd to conclude that such a private plaintiff should be entitled to the same limitations period as the necessary actor, the government. There is no such clear statutory direction.

But Congress does not "invoke" the Wartime Suspension of Limitations Act.
Rather, the Wartime Suspension of Limitations Act becomes effective when Congress declares war or authorizes the use of military force. The invocation of the Wartime Suspension of Limitations Act is at most a tertiary consideration in Congress's decision to declare war or authorize the use of military force, and thus there is only a de minimus relationship between the government conduct discussed in the Wartime Suspension of Limitations Act and any particular False Claims Act claim. By contrast, with Section 3132(b)(2) the connection between the relevant government conduct and a particular False Claims Act claim is quite close, because whether Section 3132(b)(2) tolls the limitations period turns on the government's knowledge of the alleged fraudulent conduct at issue in the particular False Claims Act claim.

The dissent also places great weight on the fact that both the Wartime Suspension of Limitations Act and its legislative history are silent regarding qui tarn relators in False Claims Act actions, arguing that this silence "strongly suggests that Congress did not intend the tolling provisions of the statute to reach indiscriminately to any private plaintiff pursuing a claim for fraud against the government." Yet the Supreme Court has admonished courts to tread carefully in attempting to find meaning in statutory silence because such silence is frequently amenable to multiple interpretations:

Not every silence is pregnant. In some cases, Congress intends silence to rule out a particular statutory application, while in others Congress' silence signifies merely an expectation that nothing more need be said in order to effectuate the relevant legislative objective. An inference from congressional silence certainly cannot be credited when it is contrary to all other textual and contextual evidence of congressional intent.

Here, finding meaning in the Wartime Suspension of Limitations Act's silence is improper because the silence just as reasonably can be interpreted as indicating that Congress did not intend to distinguish between False Claims Act actions by private plaintiffs and those in which the government is a party as it can be interpreted as excluding actions by private relators from the ambit of the Wartime Suspension of Limitations Act, as the dissent does.

Moreover, Congress's decision not to clarify the scope of "any offense" when amending the Wartime Suspension of Limitations Act in 2008 in the face of numerous decisions broadly interpreting "offense" in the Wartime Suspension of Limitations Act casts further doubt on the dissent's appeal to statutory silence. A canon of statutory construction is that "[w]e presume that when Congress amends a statute, it is knowledgeable about judicial decisions interpreting the prior legislation."

Congress amended the Wartime Suspension of Limitations Act in 2008 to broaden its scope by lengthening the tolling period and clarifying that the statute applies to Congressional authorizations of the use of military force as well as declared wars. Notably, the amendment did not in any way alter, narrow, or circumscribe the scope of the term "any offense." By the time of the
2008 amendment, numerous courts had held that the term "offense" in the earlier version of the Wartime Suspension of Limitations Act encompassed civil fraud claims, including False Claims Act cases, and the only court to address whether the Wartime Suspension of Limitations Act applies to non-intervened False Claims Act actions had determined that it did, albeit in dicta. We must presume that Congress was aware of these interpretations when it amended the Wartime Suspension of Limitations Act in 2008, and its decision not to amend the statute to exclude, or even discuss, False Claims Act actions, let alone non-intervened False Claims Act actions, in the face of this precedent suggests that it agreed with, or at least acquiesced in, these judicial decisions. In such circumstances, Congress's silence favors the majority's reading, rather than undermining it.

Thus, neither of the dissent's rationales for reading ambiguity into the plain language of the statute is persuasive. Therefore, we are left to conclude that when Congress said "any offense," it meant any offense, including offenses raised by private False Claims Act relators. Because the plain language of the Wartime Suspension of Limitations Act indicates that Congress intended the statute to apply to non-intervened False Claims Act actions, it is not our place to question the wisdom of this policy decision.

Even if the plain language of the War-time Suspension of Limitations Act would allow us to consider the policy concerns highlighted by the dissent — that our decision will "extend indefinitely" the limitations period for False Claims Act claims and will encourage would — be relators to delay filing their claims — I am not convinced that either concern is justified. First, the Wartime Suspension of Limitations Act tolls the limitations period for fraud actions for a bounded period of time: the time during which the country is at war or otherwise engaged in a military conflict. Moreover, even if the informal nature of modern military conflicts renders the limitations period established by the Wartime Suspension of Limitations Act somewhat less definite, it is within Congress's purview to determine that certain conduct is sufficiently egregious — such as defrauding the government during a time of war — that an extended or indefinite limitations period is warranted. Indeed, Congress has elected to entirely do away with limitations periods for many federal crimes.

Second, any concern that our holding will encourage relators to sit on their claims in order to maximize recovery is alleviated by the False Claims Act's public disclosure and first-to-file bars, which preclude a would-be relator from bringing a claim that is based on information that has already been publicly disclosed or that is "related" to a pending action. Regardless of the applicability of the Wartime Suspension of Limitations Act, False Claims Act relators have an incentive to bring actions as early as possible to avoid having their claims dismissed under either of these two provisions.

In sum, the majority correctly concludes that the plain language of the Wartime
Suspension of Limitations Act unambiguously encompasses False Claims Act actions in which the government is not a party. It is not this Court's — or any court's — place to revisit Congress's clearly articulated policy determinations, even when we feel they are unwise. If, after reviewing our decision, Congress agrees with the dissent that limiting the Wartime Suspension of Limitations Act to False Claims Act actions in which the government is a party is the best policy, it is free to amend the statute, as it did in 2008. Until that point, however, we are required to give effect to Congress' intent, as expressed through the plain and unambiguous language of the Wartime Suspension of Limitations Act, that the tolling applies to "any offense."

AGEE, Circuit Judge, concurring in part and dissenting in part:

I concur with the majority opinion that the "first-to-file" rule does not act as a barrier to Benjamin Carter's qui tarn action against Halliburton, Kellogg Brown & Root, and Service Employees International (collectively "KBR"). However, I do not agree with the holding in the majority opinion, principally section III D, that the Wartime Suspension of Limitations Act ("WSLA"), tolls the six-year limitations period set forth in the False Claims Act ("FCA"), 31 U.S.C. § 3731(b)(1), when the United States is not the plaintiff or an intervenor. For that reason, I respectfully dissent from the majority opinion insofar as it would allow Carter to proceed on those of his claims that fall outside the six-year FCA limitations period.

Pursuant to 31 U.S.C. § 3731(b)(1), a civil action under the FCA may not be brought more than six years after the date on which the alleged violation was committed. In this case, the vast majority of Carter's claims against KBR stem from violations that allegedly took place before May 1, 2005. Pursuant to § 3731(b)(1), therefore, Carter had until May 1, 2011, to file his qui tarn complaint against KBR for it to be deemed timely. The latest iteration of Carter's complaint, however, was not filed until June 2, 2011. Thus, absent tolling, in some form, the bulk of Carter's claims are barred by the FCA's limitations period because they did not take place within six years of the filing of the complaint.

In 1942, Congress unanimously approved the first version of the WSLA, which temporarily suspended the statute of limitations in criminal contracting fraud cases arising out of the Second World War. Congress amended the WSLA in 1948, and the majority concludes that the effect of those amendments was to extend the reach of the WSLA to civil limitations periods, not merely those arising in the criminal fraud context. The majority may be correct, but the issue is not without doubt.

In 2011, at the time Carter filed his complaint, the WSLA provided:

When the United States is at war or Congress has enacted a specific authorization for the use of the Armed Forces . . . the running of any statute of limitations applicable to any offense (1) involving fraud or attempted fraud against the United States or any agency thereof in any manner, whether by conspiracy or
This appeal presents a quintessential question of statutory interpretation, which we review de novo.

"As in all cases of statutory interpretation, our inquiry begins with the text of the statute." "In that regard, we must first determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute . . . and our inquiry must cease if the statutory language is unambiguous and the statutory scheme is coherent and consistent." "We determine the plainness or ambiguity of the statutory language . . . by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole."

II.

A.

Carter argues that, by operation of the WSLA, the FCA limitations period was suspended in 2005, at the time KBR submitted allegedly false claims to the United States for payment. Accordingly, Carter posits (and the majority opinion agrees) that the WSLA precludes KBR from asserting the statute of limitations as a defense in this case. For reasons explained below, I do not agree with that construction of the WSLA.

II.

A.
WSLA tolling were applicable. Any discussion of WSLA tolling in McCans was thus clearly unnecessary to the district court's holding that the suit was untimely. Accordingly, the court's references to the WSLA's applicability to private plaintiffs is mere dicta.

C.

As there is no direct authority for application of the WSLA here, I find the reasoning in United States ex rel. Sanders v. North American Bus Industries, Inc. a persuasive guide to our disposition of this issue. Sanders concerned the construction of 31 U.S.C. § 3731(b), the FCA's limitations provisions; the same statute providing the statute of limitations in this case. That statute provides that

[a] civil action under [the FCA] may not be brought —

(1) more than 6 years after the date on which the violation of [the FCA] is committed, or

(2) more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the official of the United States charged with responsibility to act in the circumstances, but in no event more than 10 years after the date on which the violation is committed, whichever occurs last.

The Sanders relator, whose complaint was filed beyond the six-year limitations period described in § 3731(b)(1), sought to avail himself of § 3731(b)(2), which runs the limitations period from the time the United States receives (or reasonably should receive) notice of the violation. We rejected that attempt.

Although we observed that § 3731(b) applied to "civil action[s]" under the FCA, we held that the language of § 3731(b)(2) could only be logically applied when referring to an action brought by the United States, not by a private relator. In support of this holding we reasoned that "applying the statute's language to a relator's action makes no sense whatsoever. The government's knowledge of facts material to the right of action' does not notify the relator of anything, so that knowledge cannot reasonably begin the limitations period for a relator's claims."

The Sanders court also made important observations about the practical effect of allowing a private relator to claim the benefit of a statutory limitations period intended for the benefit of the government. It noted that extending the limitations period for up to 10 years (the outer limit provided by § 3731(b)(2)) in the case of a private relator would create incentives contrary to the purposes of the FCA. "[R]elators would have a strong financial incentive to allow false claims to build up over time before they filed, there-by increasing their own potential recovery." Critically, the court went on to note that the relator's proposed construction would undermine the very purpose of the qui tam provisions of the FCA: "to combat fraud quickly and efficiently by encouraging relators to bring actions that the government cannot or will not."

Following the reasoning of Sanders in the instant case, I agree with the holding of the
district court that application of the WSLA to a suit brought by a private relator is inconsistent with the WSLA and its legislative history and would be contrary to the articulated goals of the FCA. Let me explain why that is so.

At first blush, Carter is correct that the WSLA applies to "any offense," involving fraud against the United States (obviously, when certain conditions are met). But to read "any offense" as encompassing actions by private relators is a superficial reading of the WSLA and fails to construe the statute in context. By the terms of the WSLA, the government is solely entitled to invoke and terminate the tolling provisions of the statute; however, the text of the WSLA is entirely silent as to private relators. The triggering and terminating provisions of the WSLA are both related to and solely controlled actions of the United States government: declaration of war or congressional authorization for use of military force (to trigger) and congressional resolution or Presidential proclamation (to terminate). In either circumstance, Congress and the President possess the unique power to invoke the WSLA to toll the limitations period for fraud offenses: a period when the same government is thus released from a looming time bar to bring an FCA claim. The private qui tarn plaintiff has no connection with these decisions and it seems odd to conclude that such a private plaintiff, absent a clear statutory direction, should be entitled to the same limitations period as the necessary actor, the government. There is no such clear statutory direction.

In Sanders, we declined to find that the private party relator could latch onto the § 3731(b)(2) exception since the relator was neither mentioned in the statute or legislative history as authorized to do so. Similarly, here with the WSLA, we find no mention of the private party relator in the statute or its legislative history: again, an odd basis upon which to extend the tolling of a statute of limitations which is to be strictly construed.

Simply reading "any offense" to encompass all offenses regardless of whether the United States is the plaintiff, is inconsistent with the nuanced approach that courts have employed when reading the "civil action" language in § 3731(b). We reasoned in Sanders that "a civil action" should not be read to encompass all FCA actions, but rather, should be read in context to include only those actions brought by the United States. Here, the WSLA (like § 3731(b)(2)) mentions the United States, not private relators. Thus the text of the WSLA, on its own, supports the proposition that only the United States may take advantage of its tolling provisions. Nevertheless, I also find that this interpretation is consistent with the purposes and legislative history of the WSLA.

D.

The Supreme Court has described the rationale underlying the passage of the WSLA during World War II as follows:

The fear was that the law-enforcement officers would be so preoccupied with prosecution of the war effort that the crimes of fraud
perpetrated against the United States would be forgotten until it was too late. The implicit premise of the legislation is that the frenzied activities, existing at the time the Act became law, would continue until hostilities terminated and that until then the public interest should not be disadvantaged.

In other words, the Court recognized that the primary concern motivating Congress in passing the WSLA was the ability of law enforcement to effectively police fraud against the government during the fog of war. This concern is evident in the WSLA's legislative history.

During normal times the present 3-year statute of limitations may afford the Department of Justice sufficient time to investigate, discover, and gather evidence to prosecute fraud against the Government. The United States, however, is engaged in a gigantic war program. Huge sums of money are being expended for materials and equipment in order to carry on the war successfully. Although steps have been taken to prevent and to prosecute fraud against the Government, it is recognized that in the varied dealings opportunities will no doubt be presented for unscrupulous persons to defraud the Government or some agency. These frauds may be difficult to discover as is often true of this type of offense and many of them may not come to light for some time to come. The law-enforcement branch of the Government is also busily engaged in its many duties, including the enforcement of the espionage, sabotage, and other laws.

Once again, the concern of Congress, as expressed in the legislative history, was the inability of the Department of Justice and other federal law-enforcement entities to effectively prevent and prosecute fraud in light of other duties antecedent to waging war. The legislative history makes no mention of private plaintiffs bringing relator actions against those allegedly engaged in fraud.

The legislative history of the Wartime Enforcement of Fraud Act of 2008 ("WEFA"), which contained the most recent amendments to the WSLA, reveals that the same concerns motivated Congress in passing the 2008 amendments to the WSLA. In sending the WEFA to the full Senate, the Judiciary Committee report repeatedly emphasized the difficulty of investigators, auditors, and the Department of Justice in ferreting out fraud against the United States during the conflicts in Iraq and Afghanistan. Again, the legislative history is silent with respect to private party relators.

The purpose of the WSLA (as articulated by the Supreme Court) and the legislative history of that statute confirm what the text reflects: that Congress was concerned with the ability of the federal government to police fraud when the resources of its law enforcement were stretched thin by war. Tolling afforded law enforcement the ability to thoroughly investigate allegations of fraud without compromising the ability of the United States to fulfill its military mission. Unlike federal law enforcement, private relators are not "busily engaged in . . . many duties, including the enforcement of the espionage, sabotage, and other laws." And extending the benefits of tolling to private relators does not "afford the
Department of Justice sufficient time to investigate, discover, and gather evidence to prosecute frauds against the Government." Id. In sum, Congress has shown no intent to toll the FCA's limitations period when the United States is not a plaintiff to the FCA action.

The complete silence as to relators in the legislative history of the WSLA is all the more telling when one considers that the FCA, which was originally passed in 1863, was on the books when the Congress considered the WSLA in 1942 and the WEFA in 2008. "Faced with statutory silence, we presume that Congress is aware of the legal context in which it is legislating." Thus, the fact that Congress did not mention qui tarn plaintiffs in the legislative history of any version of the WSLA strongly suggests that Congress did not intend for the tolling provisions of that statute to reach indiscriminately to any private plaintiff pursuing a claim for fraud against the government.

E.

Looking finally to the policies underlying the FCA, the majority's interpretation of the WSLA is plainly at odds with the goals of the FCA. The policy concerns underlying the FCA will be directly thwarted by allowing private relators to take advantage of the WSLA's tolling provisions. In this case, for example, Carter's claims arose in 2005, and application of the WSLA would extend the limitations period for his actions well into the next decade at least, depending on the date hostilities in Iraq are deemed terminated. Assuming for the sake of argument, as the district court did, that the August 31, 2010, presidential statement of "the end of our combat mission in Iraq" was sufficient to end the tolling provisions of the WSLA, Carter would have until 2019, nearly fourteen years after his claims accrued, to file a qui tarn action. Before the district court, Carter argued that hostilities in Iraq have not formally ended, meaning that the limitations period would still be tolled today, seven years after the allegedly false claims were presented to the government. When (and if) hostilities are formally declared terminated in Iraq, it could be up another eleven years (five years after termination of hostilities pursuant to the WSLA, plus the normal six year limitations period prescribed in § 3731(b)(1)) before the limitations period would be deemed to have ended. Such an expansive limitations period applicable to private qui tarn plaintiffs is unsupported by statute, legislative history, or precedent.

In this respect, Sanders is again instructive, because it accurately described the differing incentive structures that motivate relators, as opposed to law enforcement, in the context of FCA actions. As Sanders explained, a lengthy limitations period would create a "strong financial incentive" for relators to "allow false claims to build up over time before they filed, thereby increasing their own potential recovery." The government, on the other hand, always has an incentive to quickly act to root out fraud against the United States. The lengthy limitations period of the WSLA, therefore, is uniquely helpful to a government that is otherwise hampered from enforcing antifraud laws by the externalities of waging a military conflict. Applying that same lengthy limitations
period to relators is uniquely problematic because doing so thwarts the whole purpose of the FCA: "to combat fraud quickly and efficiently by encouraging relators to bring actions that the government cannot or will not — to stimulate actions by private parties should the prosecuting officers be tardy in bringing the suits."

In fact, the concern identified by Sanders is exacerbated in the context of wartime enforcement of anti-fraud laws. As the legislative history to the WE FA notes, "often," during war, "the Government does not learn about serious fraud until years after the fact." In contrast, private party relators will be inclined to delay, allowing their potential recovery to increase, knowing that the government is unlikely to discover the fraud, and therefore unlikely to be the first to bring a claim against the perpetrators. Absent WSLA tolling, relators are at least restricted to a six year window in which to bring their claims. In the context of virtually indefinite WSLA tolling, however, a relator could wait a decade or more to bring a qui tarn claim, secure in the knowledge that law enforcement is otherwise too occupied with the exigencies of war to discover the fraud on its own.

F.

The majority opinion does not address the arguments set forth above, but summarily dismisses Sanders as inapplicable because, "whether the suit is brought by the United States or a relator is irrelevant to this case because the suspension of limitations in the WSLA depends on whether the country is at war and not who brings the case." This is a misreading of Sanders, the statute, and the legislative history. Like the WSLA, the limitations period at issue in Sanders did not contain an express limitation on who could take advantage of the tolling provision. Rather, the analysis in Sanders focused on whether § 3731(b)(2) could be plausibly read to encompass actions brought by private parties. Like § 3731(b)(2) in Sanders, the WSLA should be read in context, keeping in mind both the purposes of that statute and the dire effects of extending to relators a provision obviously intended only for the government.

III.

The text, the purposes, and the legislative history of the WSLA all counsel in favor of holding that the government only, and not private relators, are entitled to take advantage of that statute's tolling provisions. Because the majority takes the altogether novel step of expanding the WSLA to apply to actions by relators, I must respectfully dissent from that aspect of the majority's holding.
Yesterday, the Supreme Court granted certiorari in *Kellogg Brown & Root v. United States ex rel. Carter*, No. 12-1497, a case presenting two important issues under the False Claims Act (FCA). The first is whether the Wartime Suspension of Limitations Act—which tolls the limitations period during wartime for any "offense" against the United States—applies to a civil FCA claim brought by a qui tam relator. The second is whether the FCA's "first-to-file bar"—which provides that once a relator brings an FCA action, "no person other than the government may intervene or bring a related action based on the facts underlying the pending action"—precludes a later action only so long as the earlier action is still pending.

**Background**

Petitioner Kellogg Brown & Root (KBR) provided logistical services to the U.S. military during the Iraqi war. In 2006, Respondent Carter, a former KBR employee, filed an FCA action against KBR, alleging that KBR had fraudulently billed the government. After a lengthy procedural history, the district court (Cacheris, J.) dismissed the latest complaint with prejudice. The court first held that the first-to-file bar, 31 U.S.C. § 3730(b)(5), precluded Carter's action because another FCA case alleging similar facts had already pending in another federal district court when Carter filed his operative complaint. Although that other case had since been dismissed, the district court here held that the first-to-file bar depended on the state of affairs at the time of the filing of the complaint. The court also held that most of Carter's claims were time-barred, rejecting his argument that the Wartime Suspension of Limitations Act (WSLA), 18 U.S.C. § 3287, tolled the limitations period. The court ruled that the WSLA does not apply to a civil fraud claim brought by a qui tam relator.

The Fourth Circuit reversed. The court held that although the complaint was properly dismissed under the first-to-file bar, because the earlier-filed case had still been pending at the time Carter filed his latest complaint, the dismissal should have been without prejudice because the subsequent dismissal of that case meant that the first-to-file bar no longer applied, leaving Carter free to re-file. The court of appeals also held that Carter's claims were not time-barred because the WSLA applies to civil FCA suits, even those in which the government has declined to intervene. One judge dissented from this portion of the court's ruling, arguing that the WSLA does not apply to qui tam suits in which the government has declined to intervene.

In its certiorari petition, KBR argues that the Fourth Circuit's first-to-file rule would
improperly allow relators to bring case after related case based on very similar facts, so long as they were brought seriatim. On the WSLA question, KBR contends that the term "offense" is limited to crimes, that the Fourth Circuit's approach is contrary to the WSLA's purpose, and that the Fourth Circuit's decision would lead to enormously long periods of tolling given the nature of the military conflicts in which the United States is engaged.

Next Steps

The case will likely be argued in December 2014 or January 2015. KBR's opening brief is due August 15, 2014 and Carter's opposition brief is due September 15, 2014, though those deadlines may well be extended.
Last week, the Supreme Court granted certiorari in the case of *Kellogg Brown & Root Services v. U.S. ex rel. Carter*, adding another appeal involving a whistleblower to its schedule in the fall. The petition initiated by KBR asked the Court to review the appropriate statute of limitations and the application of the first to file bar in False Claims Act litigation.

The history of the case is a bit unusual. Benjamin Carter, the relator who worked for the defendant in Iraq, filed a *qui tam* complaint in 2006. The complaint was amended in 2008 to include allegations of false billing for labor costs. This complaint was dismissed by the district court because of similar allegations in a pending relator complaint filed prior to Carter’s allegations.

As those familiar with the False Claims Act are aware, the statute bars a person from bringing a “related action based on the facts underlying the pending action.” 31 U.S.C. § 3730(b)(5). This is commonly known as the “first to file” bar.

While on appeal, the complaint by the other relator was dismissed. Carter filed a new complaint in 2010. However, since his 2008 appeal was still pending, the new complaint was dismissed because of his own pending appeal. Strategically, Carter dismissed the appeal of the 2008 complaint.

By the time Carter refiled his complaint, another relator had filed against the company with similar allegations. The district court held that this pending complaint barred Carter’s latest complaint. Because a significant amount of time had passed since the events underlying this litigation, the district court also held that most of the allegations were now barred by the statute of limitations of the False Claims Act, set forth in § 3731(b).

Carter appealed successfully to the Court of Appeals. The Fourth Circuit held that the statute of limitations in the case was tolled by the Wartime Suspension of Limitations Act (WSLA). It also authorized him to refile his complaint because there were no other pending actions.

The defendant now contests those issues on appeal.

It contends that the WSLA applies solely to criminal cases brought by the government. It makes three key arguments:

1. The WSLA does not apply to civil fraud cases where the U.S. government is not a party;

2. The WSLA does not apply when the government has not formally declared war; and
3. The WSLA does not modify the ten year statute of repose in the False Claims Act. In other words, the WSLA does not indefinitely toll the statute of limitations.

The Supreme Court will also review whether a previous lawsuit, not dismissed on the merits, bars a subsequent relator from filing a *qui tam* lawsuit because of the “first to file” requirement of the False Claims Act. The defendant contends dismissal is appropriate because the government has already been put on notice of the fraud.

KBR is the second case involving a whistleblower to be scheduled by the Supreme Court. In May, it agreed to hear the appeal of Homeland Security in the case of TSA air marshall Robert MacLean, *Department of Homeland Security v. MacLean.* MacLean informed the media that the TSA had discontinued posting air marshals on certain overnight flights because of budget concerns despite an alert about a plot to hijack airlines. He was terminated when the TSA learned of his role blowing the whistle. The Federal Circuit Court of Appeals sided with MacLean in his retaliation claim under the Whistleblower Protection Act.

The Supreme Court has already weighed in on two cases involving whistleblowers this year.

A few weeks ago in June, the Supreme Court decided *Lane v. Franks.* Lane, in his capacity as director of a statewide program for underprivileged youth, terminated an individual on the payroll that had not been reporting to her office. Subsequently, Lane was compelled to testify in the ex-employee’s criminal trial. He alleged that he was terminated in retaliation for the testimony. In a 9-0 opinion written by Justice Sotomayor, the Court held that the First Amendment protects a public employee providing truthful sworn testimony, compelled by subpoena, outside the course of the employee’s ordinary job duties.

In March, it extended SOX protections against retaliation to whistleblowers who work at private contractors to public companies in *Lawson v. FMR LLC.* The decision reversed the First Circuit decision denying protection to two employees of a privately held financial institution providing services to mutual fund clients.
“The Supreme Court Will Review Fourth Circuit Decision that Weakened the False Claims Act’s Statute of Limitations and First-to-File Bar”

Vorys
Patrick M. Hagan & Brent D. Craft
July 1, 2014

Today, the Supreme Court granted the petition for certiorari in Kellogg Brown & Root Servs., Inc. v. United States ex rel. Carter. The petition presented two questions: (1) whether the Wartime Suspension of Limitations Act (WSLA) applies to claims of civil fraud brought by qui tam relators, and (2) whether the False Claims Act’s (FCA) first-to-file rule is an absolute bar or whether it permits subsequent actions so long as the first-filed action had been dismissed on non-merits grounds prior to filing of the subsequent action. The Fourth Circuit’s decision was unfavorable to potential FCA defendants on both issues. The Supreme Court’s decision to grant certiorari is important news for all companies that do business with the government, as both issues significantly impact potential FCA exposure.

On the first question, the Fourth Circuit held that the WSLA applies to civil as well as criminal cases, and applies to FCA actions in which the government has declined to intervene. The practical effect of that ruling is that the statute of limitations in all FCA cases is tolled while the United States is at war (defined broadly to include all conflicts for which Congress has authorized the use of the Armed Forces) until “5 years after the termination of hostilities as proclaimed by a Presidential proclamation, with notice to Congress, or by a concurrent resolution of Congress.” District courts have begun to issue contrary rulings, with courts in both the Eastern and Western District of Pennsylvania holding that the WSLA does not apply to non-intervened FCA cases. Most recently, in the well-known “Lance Armstrong case,” the District of D.C. held that the WSLA does not apply to any civil FCA cases because the FCA does not require “proof of specific intent to defraud.”

On the second question, the Fourth Circuit joined the Seventh and Tenth Circuits in holding that the FCA’s first-to-file rule does not prohibit duplicative actions so long as the earlier-filed actions are not pending at the time the duplicative case was filed. That conflicts with the approach taken by the First, Fifth and Ninth Circuits, which have held that allowing duplicative actions to proceed, regardless of whether the previously filed action was “pending” at the time, “cannot be reconciled with [the FCA’s] goal of preventing parasitic [suits].”

If the Supreme Court upholds the Fourth Circuit’s ruling on both of these issues, the consequences for FCA defendants could be disastrous. The application of the WSLA to all civil FCA cases, including non-intervened cases, essentially eliminates the statute of limitations for FCA cases indefinitely. Indeed, the president recently
ordered additional troops to Iraq to address the recent instability there, which suggests that the “termination of hostilities” in Iraq is not imminent. The weakening of the first-to-file rule compounds the harm caused by the tolling of the statute of limitations by decreasing incentives for relators to report fraud promptly. The practical effect of the Fourth Circuit’s “one-two punch” to defendants is to encourage relators to delay filing claims to maximize the potential damages. These incentives directly conflict with the purpose of the FCA.

When read in its entirety, the dual purposes of the FCA are to provide financial incentives to encourage private citizens to promptly report fraud while limiting the ability of those whistleblowers to profit based on publicly disclosed, previously alleged or stale information. Three pillars of the FCA provide the limitations on relators. The public disclosure bar prevents relators from profiting from suits based upon information that was already publicly available. The first-to-file rule serves a similar purpose – once the government has been alerted to potential fraud by the first-filed qui tam action, there is no reason to incentivize additional lawsuits. Finally, the vast majority of courts have correctly held that relators cannot benefit from the tolling provision in the FCA’s statute of limitations and thus, that the limitations period for non-intervened cases is six years (as opposed to up to 10 years for the government). All three of these provisions of the FCA provide incentives for relators to make prompt allegations of fraud.

Unfortunately, the 2010 amendments to the FCA have already weakened the public disclosure bar by leaving its application to the government’s discretion. The Fourth Circuit’s holding in Carter undermines both the statute of limitations and the first-to-file rule. If the Fourth Circuit’s reasoning is upheld, companies doing business with the government could face lawsuits for alleged FCA violations that occurred many years earlier. Defending old claims is often difficult. Paper documents are often destroyed in accordance with document management policies or are stored in less accessible locations. The relevant electronic files may be stored on a sunset email or document management system. Witnesses may have moved away or forgotten relevant facts. Some may even be dead. And, if the relator alleges a continuing violation, the potential damages and penalties that have accumulated over a long period of time may be astronomical.

Amicus curiae briefing on the petition for certiorari in Carter illustrates that this case is set for a showdown. In his amicus brief, the solicitor general indicated that the government would support the Fourth Circuit’s application of the WSLA to all civil FCA cases and its interpretation that the first-to-file rule does not bar subsequent actions when the first-filed action is no longer pending. The Chamber of Commerce filed an amicus brief in support of the defendant to alert the Court that “the sum effect of [Carter] will be to increase the number of aged and duplicative cases that serve only to inflict substantial litigation costs on businesses.” All companies that in some way do business with the government
– including health care, government procurement and banking and finance – should closely watch this case during the Supreme Court’s October term.
Halliburton Co. and KBR Inc. (KBR) must face a whistle-blower lawsuit that was revived by a federal appeals court, which ruled that military operations in Iraq exempted the plaintiff from a six-year deadline for filing claims.

In a 2-1 ruling today, the U.S. Court of Appeals in Richmond, Virginia, reversed a lower-court judge’s dismissal of a case against the companies filed by Benjamin Carter under the False Claims Act. Carter’s claims that Halliburton and KBR falsely billed the U.S. in 2005 triggered the Wartime Suspension of Limitations Act even though the Justice Department declined to intervene in the case, the judges said.

“Whether the suit is brought by the U.S. or a relator is irrelevant to this case because the suspension of limitations in the WSLA depends on whether the country is at war and not who brings the case,” U.S. Circuit Judge Henry Floyd wrote in the ruling.

Carter, who worked for KBR as an operator in a water purification unit in 2005, alleges the companies billed the U.S. government for purifying water for four months at two Iraqi camps that year when it hadn’t done so. He also alleges he had his colleagues instructed to submit time sheets showing that they worked 12-hour days on the purification when he hadn’t worked on it at all.

Carter first sued in 2006. That case and three subsequent complaints were dismissed on procedural grounds. In sending the case back to U.S. District Judge James Cacheris in Alexandria, Virginia, the appeals court said Carter’s claims may still be barred under a different provision of the false claims law.

Dissenting Judge

U.S. Circuit Judge G. Steven Agee, in a dissenting opinion to today’s decision, said people might allow false billing to continue knowing that they have more than a decade to file a claim and that their reward is tied to the size of a recovery.

“Private party relators will be inclined to delay, allowing their potential recovery to increase, knowing that the government is unlikely to discover the fraud, and therefore unlikely to be the first to bring a claim against the perpetrators,” Agee said.

Susie McMichael, a spokeswoman for Houston-based Halliburton, referred questions to KBR, stating that the activity alleged in the lawsuit was pursuant to a KBR contract.

John Elolf, a spokesman for Houston-based KBR, said in a statement that the company was disappointed with the ruling and “respectfully disagrees” with the majority’s opinion.
“KBR is continuing to study the decision and weighing our options,” he said. “We believe the underlying case is without merit, and we are confident that it will ultimately be dismissed.”

The case is *United States ex rel. Benjamin Carter v. Halliburton Co.* (HAL), 12-01011, U.S. Court of Appeals for the Fourth Circuit (Richmond).