No. 07-961

In The
Supreme Court of the United States

Centerior Energy Corporation, *et al.*,
Petitioners,
v.

Jerome R. Mikulski and Elzetta C. Mikulski,
on behalf of themselves and all others
similarly situated,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

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Questions Presented

1. Whether the Sixth Circuit correctly applied to the specific facts of this case the well-settled rule, recently reaffirmed in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308 (2005), and *Empire Health-Choice Assurance, Inc. v. McVeigh*, 547 U.S. 677 (2006), that federal jurisdiction does not exist over a state-law claim requiring resolution of an embedded federal question when the federal issue is not "substantial" and when federal jurisdiction would impermissibly disturb the "congressionally approved balance of federal and state judicial responsibilities," *Grable*, 545 U.S. at 314; *see Empire*, 547 U.S. at 701.

2. Whether 26 U.S.C. § 7422, which governs administrative claims for tax refunds from the Internal Revenue Service, completely preempts tort and contract claims between private parties, for which injuries (calculated as equivalent to excess tax liability) are recoverable as consequential or compensatory damages.

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Introduction

A plaintiff is "the master of the complaint," and "the well-pleaded-complaint rule enables" it to "eschew[] claims based on federal law" and thereby "to have the cause heard in state court." *Holmes Group, Inc. v. Vornado Air Circulation Sys., Inc.*, 535 U.S. 826, 831 (2002) (internal quotation marks omitted). In this case, respondents asserted tort and contract claims under Ohio common law against petitioners alleging, among other things, that petitioners violated an obscure provision of the federal tax code. In a careful and well-reasoned opinion, the Sixth Circuit applied this Court's holdings in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308 (2005), and *Empire HealthChoice Assurance, Inc. v. McVeigh*, 547 U.S. 677 (2006), and concluded, correctly, that the exercise of federal jurisdiction would not be appropriate in the circumstances of this case.

The petition presents no question warranting this Court's review. Petitioners first assert that the Sixth Circuit misapplied *Grable* and created a conflict with the Second, Tenth, and Federal Circuits, in holding that federal jurisdiction could not be exercised over respondents' state-law claims. In fact, the Sixth Circuit's analysis accords with *Grable* and with the analysis of every other court of appeals. Each of the circuits, including the court below, carefully applied *Grable* to the specific facts of the complaint before it. Here, the Sixth Circuit concluded – based on the specific federal statutory provision at issue (as petitioners have conceded, an "obscure" provision of the federal tax code, Pet'rs C.A. Br. 24 (filed July 9, 2004)) and the particular state-law claims (garden-variety claims of breach of contract and fraudulent misrepre-

sentation) – that exercising federal jurisdiction would be inappropriate under *Grable*. Petitioners cite no other case involving a similar statutory provision or similar claims. The case-specific question – whether the Sixth Circuit erred in concluding that the state-law claims raised in respondents' complaint do not arise under federal law within the meaning of 28 U.S.C. § 1331 – does not warrant this Court's review.

Petitioners next contend that the Sixth Circuit split from the Fifth, Seventh, and Ninth Circuits in holding that respondents' claims are not completely preempted as disguised federal tax-refund claims. But the cases on which petitioners rely all involve a federal statutory provision requiring airlines to collect from airline passengers, and to remit to the Internal Revenue Service (IRS), a 10-percent excise tax on airline tickets. The airlines continued to collect the excise tax even after it expired, and the courts of appeals held that the plaintiffs must seek a refund from the IRS. Here, in contrast, petitioners did not act as IRS tax *collection* agents; rather, by paying out tax-free return of capital to its shareholders, but *reporting* those payments to be taxable dividends, petitioners misrepresented tax-related information to shareholders and the IRS alike. Unlike in the airline excise-tax cases, the tax here was properly assessed (albeit based on incorrect information) and paid by respondents directly to the IRS. Petitioners further ignore the fact that Congress's subsequent enactment of 26 U.S.C. § 7434, which provides a private, federal right of action for the exact type of tax misreporting alleged here, eliminates the continuing importance of the question presented.

Statement of the Case

a. The nature of the case.

Respondents Jerome R. Mikulski[1] and Elzetta C. Mikulski are California taxpayers who were shareholders of Centerior Energy Corporation, its predecessor companies, Cleveland Electric Illuminating Company and the Toledo Edison Company, and its successor company, FirstEnergy Corporation (collectively, "Centerior"), during the years relevant to this case, from 1985 to 1997. As a publicly traded company, Centerior is subject to myriad obligations to its shareholders under shareholder agreements, state law, and federal law. As relevant here, the shareholder agreement and 26 U.S.C. § 6042(c) obligate Centerior to report accurately to each shareholder dividends paid and returns of capital made in each tax year on a Form 1099-DIV. That obligation, in turn, requires Centerior to calculate accurately its "earnings and profits" (E&P), because a corporation's dividends cannot exceed the amount of E&P. Any distributions in excess of E&P are treated as return of capital. *See* Pet. App. 30a. The distinction between dividends and return of capital is significant: whereas dividends were taxed as ordinary income during the relevant years in this case (at a rate of up to 50 percent), a return of capital is generally tax-free. *See id.* at 76a.[2]

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[1] Jerome R. Mikulski passed away last year, and his estate has been substituted as plaintiff in the three cases pending in the Court of Common Pleas for Cuyahoga County, Ohio. A motion to substitute is pending in the Lucas County case.

[2] There is an exception to this general rule. Capital may be "returned" only up to the cost basis of the stock, *i.e.*, the amount initially paid by the shareholder. Once that cap is met, additional return of capital is taxed as a capital gain. For most

In 1984, Congress passed the Deficit Reduction Act, which, among other things, changed the treatment of interest incurred on construction projects in calculating E&P. *See* Pub. L. No. 98-369, § 61(e), 98 Stat. 494, 582. The Act required corporations to capitalize – that is, to treat as a depreciable asset – interest incurred on construction-related debt. *See* 26 U.S.C. § 312(n)(1). That change affected the calculation of E&P, because capitalizing interest, rather than deducting it, results in higher E&P. Higher E&P, in turn, increases the amount of funds available for dividend payments to shareholders and reduces the amount of any distribution that is characterized, instead, as (generally tax-free) return of capital. The Act was effective "in taxable years beginning after September 30, 1984," § 61(e)(1)(A), 98 Stat. 582; thus, for petitioners, the Act took effect January 1, 1985.

As of December 31, 1984, Centerior had incurred $1.5 billion of debt on "construction in progress" – nuclear power plants and other facilities on which construction had begun, but had not been completed. Even though that debt was attributable to construction occurring before the Act's effective date, Centerior capitalized, and did not deduct, the interest expense on this "construction in progress" debt in calculating E&P for 1985 and subsequent years.

b. The district court proceedings.

The Mikulskis are named plaintiffs in four class-action lawsuits filed on behalf of Centerior shareholders in the Courts of Common Pleas for Cuyahoga and Lucas Counties, Ohio, alleging breach of contract

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taxpayers, however, the tax rate on capital gains also was lower than the tax rate on dividends during the years in question.

and fraudulent misrepresentation under Ohio law. Specifically, the Mikulskis allege that Centerior violated its shareholder agreements and § 6042(c) by providing inaccurate Forms 1099-DIV to shareholders. The Mikulskis further allege that Centerior fraudulently misrepresented the amount of taxable dividends paid to shareholders by including interest incurred on pre-1985 construction-in-progress in E&P, in violation of § 312(n)(1). The Mikulskis seek damages equivalent to the amount of state and federal income taxes overpaid.

Eleven months after the first lawsuit was filed, petitioners removed all four actions to federal court under 28 U.S.C. § 1441(b), asserting that the Mikulskis' state-law claims arose under federal law within the meaning of 28 U.S.C. § 1331. *See* Pet. App. 75a. Petitioners argued that the 30-day deadline for removal in 28 U.S.C. § 1446(b) did not bar removal of the first case because it was unclear that the Mikulskis' claims required interpretation of the federal tax code until the Mikulskis specifically relied on § 312(n)(1) in a supplemental interrogatory response. The Mikulskis filed motions to remand, arguing both that Centerior's removal of the first case was untimely and that the state-law claims did not raise a federal question sufficiently substantial to support federal jurisdiction under this Court's cases. The district court denied the motions to remand and, following consolidation of the proceedings, also denied a motion for reconsideration. *See id.* at 84a.

Petitioners then moved for judgment on the pleadings on the ground that the Mikulskis' state-law claims were preempted by § 7422, which requires a taxpayer seeking recovery of any "internal revenue tax alleged to have been erroneously or illegally

assessed or collected" to file an administrative refund claim with the IRS. 26 U.S.C. § 7422(a). The magistrate judge agreed, and the district court adopted the magistrate judge's report and recommendation. *See* Pet. App. 77a-80a. Accordingly, the district court granted judgment on the pleadings for petitioners. *See id.* at 80a-81a.

c. The court of appeals panel proceedings.

On appeal, a panel of the Sixth Circuit reversed the district court's judgment and ordered the case remanded to state court. *See* Pet. App. 49a-73a. The court of appeals first rejected petitioners' argument that federal jurisdiction existed because respondents' claims were completely preempted by § 7422. It explained that a state-law claim is not converted into a federal tax-refund action under § 7422 simply because "damages are measured in taxes." *Id.* at 60a. The court further observed that the district court "seems to be the first court in the country to find complete preemption in the Internal Revenue Code" and warned that, "[i]f the district court were correct, it would federalize most state law claims that remotely address tax issues, such as suing one's accountant or tax preparer." *Id.* at 62a-63a.

The appellate panel also held that the substantial-federal-question doctrine did not provide a basis for federal jurisdiction under the specific facts of this case. *See id.* at 68a-69a. The court explained that, notwithstanding the relevance of federal tax law to the case, "the true issues in this case are breach of contract and fraudulent misrepresentation." *Id.* It reasoned that, although damages were to be measured by the amount of federal and state taxes overpaid by the Mikulskis, a court need only engage in "insubstantial analysis or interpretation of federal

law" in deciding the merits of the case because "[t]he true questions at issue in the case involve fraud and misreporting to shareholders, both of which claims are governed by state statutes." *Id.* at 69a. (The Sixth Circuit did not address the Mikulskis' alternative argument that petitioners' removal of the first suit was untimely.)

Judge Daughtrey concurred in part and dissented in part. She agreed with the majority's conclusion that the Mikulskis' claims were not preempted, *see id.* at 69a-70a, but disagreed with the majority's remand to state court because, in her view, the interpretation of § 312(n)(1) was "substantial," *see id.* at 71a-72a. Judge Daughtrey recognized that, in contrast to *Grable*, where the outcome of the case turned solely on the resolution of the federal question, the meaning of § 312(n)(1) is not the only disputed issue in this case. *See id.* at 70a (noting that tax overpayment "may or may not represent the actual damage from the injuries alleged"). Nevertheless, she concluded that the federal issue in this case is substantial because petitioners' compliance with § 312(n)(1) is an "essential" element of the Mikulskis' state-law claims, *see id.* at 72a, and because "[t]he federal government's interest in the construction of a statute that controls how much tax security-holders must pay is surely as great as its interest in being able to collect delinquent taxes by seizing and selling properties," *id.*

Judge Daughtrey also recognized that a decision finding federal jurisdiction might "invite a flood" of similar state-law claims into the federal court, but suggested that statutes of limitations and IRS refund procedures may "act as a reasonable limit" on the

increase in cases brought in federal courts. *Id.* at 72a-73a.

d. The *en banc* Sixth Circuit decision.

In April 2006, the Sixth Circuit granted petitioners' request for rehearing *en banc* and vacated the panel opinion. In August 2007, the *en banc* court of appeals entered an opinion reversing the district court's judgment and ordering the case remanded to state court. The court held unanimously that § 7422 does not completely preempt the Mikulskis' claims. *See* Pet. App. 17a-20a, 41a. The court explained that the Mikulskis' claims could not be deemed a tax-refund action because, "[u]nder the plaintiffs' theory, the IRS was an innocent third-party, who, like the plaintiffs themselves, merely relied on the 1099-DIVs issued by Centerior, while Centerior was the active (i.e., liable) tortfeasor." *Id.* at 19a.

The court of appeals also concluded that *Grable* and *Empire* did not permit the exercise of federal jurisdiction under the specific facts of this case. *See id.* at 40a. Although the court acknowledged that the effective-date provision of § 312(n)(1) is "disputed," *id.* at 28a, the court determined that, under the four-factor test articulated in *Empire*, this particular federal issue is not "substantial," *see id.* at 31a. The court explained that, under *Empire*, the absence of a federal agency or a question of an agency's compliance with federal law weighs against federal jurisdiction. *See id.* at 32a. The court further concluded that the federal question in the case – the proper interpretation of the effective-date provision of § 312(n)(1) – is a relatively narrow, unimportant issue that the IRS had never litigated. *See id.* at 33a. The court also noted that resolution of the federal issue would not resolve the case, as the Mikulskis still must

prove the remaining elements of fraudulent misrepresentation and breach of contract. *See id.* at 33a-34a. And the court explained that the effective-date provision of § 312(n)(1) would not likely control the outcome of other cases because disputes over that provision could only arise for interest incurred in or around 1984, and such cases would be rare. *See id.* at 34a-35a. Finally, the court cautioned that to exercise federal jurisdiction in this case "would impermissibly disrupt the congressionally approved balance of federal and state judicial responsibilities," *id.* at 38a (citing *Grable*, 545 U.S. at 315), and would create a "real and significant" risk of opening the federal courts to "any dispute over the meaning or effect of virtually any provision in the entire federal tax code," *id.* at 39a.

Judge Daughtrey again dissented from the court's conclusion that the federal issue here is not "substantial." Judge Daughtrey stated that interpretation of federal tax law is a "paramount" federal interest and that this case is no exception because "the effective date of a statutory provision . . . affects directly how much tax security-holders must pay." *Id.* at 45a (internal quotation marks omitted). In Judge Daughtrey's view, the IRS's failure to litigate a claim under § 312(n)(1) "bears no necessary correlation to the importance of the subject matter." *Id.* at 46a. Likewise, although Judge Daughtrey acknowledged that, to prevail, the Mikulskis must prove other (non-federal) elements of their breach-of-contract and fraudulent-misrepresentation claims, she believed that factor was outweighed by the fact that § 312(n)(1)'s effective-date provision is "essential" to the Mikulskis' claims. *See id.* at 46a-47a. Finally, Judge Daughtrey reiterated her belief that the

number of cases involving state-law claims implicating a provision of the federal tax code actually shifted into federal court would be limited by statutes of limitations and IRS refund procedures. *See id.* at 48a.

Reasons for Denying the Petition

I. The Court of Appeals' Decision Denying Federal Jurisdiction Correctly Applied *Grable* and *Empire* to the Facts of this Case and Applies the Same Legal Standard as Every Other Court of Appeals.

Petitioners' principal submission is that the Sixth Circuit misapplied *Grable* in concluding that respondents' state-law claims do not arise under federal law. *See* Pet. 9-10. Certiorari is not warranted to consider that case-specific question. The narrow issue resolved below – whether a federal court should assert jurisdiction over state-law claims of breach of contract and fraudulent misrepresentation that involve the interpretation of the effective-date provision of an obscure section of the federal tax code – has not been decided by any other court of appeals. The legal standard to be applied in resolving such questions is well-settled, and the courts of appeals uniformly agree that whether an embedded federal question supports federal jurisdiction depends on the provision of federal law in question in the context of the particular state-law claim. The Sixth Circuit correctly applied this Court's precedents to the circumstances of this case, and further review is not warranted.

A. The Sixth Circuit Correctly Applied this Court's Precedents to the Circumstances of this Case.

This Court explained in *Grable* that whether a federal court should exercise subject-matter jurisdiction over a state-law claim with an embedded federal issue requires, in Justice Cardozo's words, a "'common-sense accommodation of judgment to [the] kaleidoscopic situations'" under which the issue may arise. 545 U.S. at 313 (quoting *Gully v. First Nat'l Bank*, 299 U.S. 109, 117-18 (1936)) (alteration in original). And the Court confirmed in *Empire* that only a "special and small category" of state-law claims will be subject to federal jurisdiction based on the presence of an embedded federal question. 547 U.S. at 699. This case does not fall into "the slim category *Grable* exemplifies," *id.* at 701, as the Sixth Circuit properly held. Petitioners' contrary contentions are unpersuasive.

1. The Sixth Circuit faithfully applied this Court's decisions.

As *Grable* directs, the court of appeals considered whether the embedded federal issue was "substantial" and one that "a federal forum may entertain without disturbing any congressionally approved balance of federal and state judicial responsibilities." 545 U.S. at 314; *see* Pet. App. 31a-40a. In considering whether the federal issue in this case is "substantial" under this Court's cases, the Sixth Circuit correctly focused on four factors the Court emphasized in *Empire*: (1) whether the case includes a federal agency or the agency's compliance with a federal statute; (2) whether the federal question is important; (3) whether resolution of the federal question will dispose of the case; and (4) whether resolution of

the federal question will control numerous other cases. *See* Pet. App. 26a-27a, 31a; *Empire*, 547 U.S. at 700.

The court first correctly noted that, unlike *Grable*, and like *Empire*, the present dispute does not involve the actions of a federal agency. *See* Pet. App. 32a; *Empire*, 547 U.S. at 700 (discussing *Grable*). Nor is the federal issue involved here sufficiently important to justify the exercise of federal jurisdiction over respondents' state-law claims. As the Sixth Circuit explained, the only federal issue involves the effective date of § 312(n)(1), which governs the treatment of interest expense incurred near that date. *See* Pet. App. 30a. There is no dispute over the meaning or application of the substantive terms of that statutory provision. As the Sixth Circuit also noted, the IRS has never litigated a case involving § 312(n)(1). *See id.* at 33a. Further, although Congress invited the IRS to issue regulations interpreting § 312(n)(1),[3] the IRS has not yet seen the need to do so. Significantly, despite the absence of regulatory guidance, *no* court – *state or federal* – has found it necessary to interpret § 312(n)(1).

The court of appeals also recognized that respondents' claims for breach of contract and fraudulent misrepresentation would not be disposed of by resolution of the federal issue. *See id.* at 33a-34a. Respondents must prove additional elements wholly unrelated to the tax issue, including that petitioners made affirmative misrepresentations with intent to

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[3] *See* Staff of J. Comm. on Taxation, 98th Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 177 (Comm. Print 1984).

mislead.[4] In *Grable*, by contrast, resolution of the federal issue was "dispositive of the case." *Empire*, 547 U.S. at 700.

In addition, the Sixth Circuit correctly reasoned that the court's interpretation of the effective-date provision of § 312(n)(1) would not likely control the outcome of other cases because the effective date will affect only the treatment of interest incurred on or near the provision's 1984 effective date. *See* Pet. App. 34a-35a. Because more than 23 years have elapsed since that statute was enacted, there is a small (and ever-diminishing) likelihood that other lawsuits will hinge on this precise issue of federal tax law. As the Court made clear in *Empire*, federal jurisdiction is not appropriate when, as here, the state-law claim at issue "is fact-bound and situation-specific" and resolution of the federal issue would not "be controlling in numerous other cases." 547 U.S. at 700-01.

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[4] To succeed on a fraudulent-misrepresentation claim under Ohio law, a plaintiff must establish the following elements: "(1) a representation, or where there is a duty to disclose, concealment of a fact, (2) which is material to the transaction at hand, (3) made falsely, with knowledge of its falsity, or with such other disregard and recklessness as to whether it is true or false that knowledge may be inferred, (4) with the intent of misleading another into relying on it, (5) justifiable reliance upon the representation or concealment, and (6) a resulting injury proximately caused by the reliance." *Fifth Third Bank v. Cope*, 835 N.E.2d 779, 787-88 (Ohio Ct. App. 2005) (internal quotation marks omitted). To establish a claim for breach of contract under Ohio law, a plaintiff must demonstrate: the existence of an agreement; the non-breaching party fulfilled its obligations under the agreement; the breaching party lacked legal justification for failing to fulfill its obligations; and damages to the non-breaching party. *See Lawrence v. Lorain Cty. Community College*, 713 N.E.2d 478, 480 (Ohio Ct. App. 1998).

Finally, the Sixth Circuit also correctly concluded that the exercise of federal jurisdiction in this case would be inconsistent with the "congressional judgment about the sound division of labor between state and federal courts" that "govern[s] the application of § 1331." *Grable*, 545 U.S. at 313-14. Asserting federal jurisdiction here would risk opening the federal courts to "any dispute over the meaning or effect of virtually any provision in the entire federal tax code." Pet. App. 39a. Because many traditional state-law claims, such as fraud, misrepresentation, and malpractice, involve embedded issues of federal tax law, a decision requiring *any* interpretation of federal tax law to be handled by a federal court would greatly "disturb[]" the congressional balance of state and federal judicial responsibilities. *Grable*, 545 U.S. at 314.

In sum, although the meaning of § 312(n)(1)'s effective-date provision is disputed, it is not a substantial federal issue in the context of this case. Furthermore, the exercise of federal jurisdiction in this case would risk disturbing the federal-state division of judicial responsibilities. Thus, the court of appeals correctly concluded that removal jurisdiction was improper in this case.

2. Petitioners' criticisms of the court of appeals' decision are unwarranted.

Contrary to petitioners' protests, there is no inconsistency between the decision below and *Grable*. As in *Empire*, "[t]his case is poles apart from *Grable*." 547 U.S. at 700.[5] Petitioners acknowledge that no

[5] Petitioners misleadingly characterize respondents' brief *amici curiae* in support of the petitioner in *Grable* as a concession that "the two cases cannot fairly be distinguished." Pet. 12.

federal agency action is implicated in the present dispute, but dismiss that fact as "beside the point" because it "was not even mentioned in this Court's opinion" in *Grable*. Pet. 15. But this Court emphasized that point in denying federal jurisdiction in *Empire*, *see* 547 U.S. at 700 – a case that petitioners mention only in a dismissive footnote, *see* Pet. 19 n.7 – and, thus, the absence of a federal agency similarly weighs against federal jurisdiction here.

Petitioners argue that the government has a strong "federal interest in properly determining the effective date of tax provisions governing the amount of taxes owed (as in this case)" because resolution of this question "can have a significant impact on revenue collection." Pet. 12-13. But petitioners themselves conceded in the Sixth Circuit that § 312(n)(1) is "a particularly obscure and indefinite statutory provision." Pet'rs C.A. Br. 24. The IRS has never litigated a case involving § 312(n)(1), *see* Pet. App. 33a, and no court has found it necessary to interpret the provision. Moreover, as the Sixth Circuit recognized, only a dispute regarding construction interest incurred in or near the 1984 effective date of § 312(n)(1) would be implicated by the holding in this case, and such a dispute – which evidently has never arisen outside of

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Respondents urged the Court in *Grable* to adopt a rule providing for federal jurisdiction only if a federal cause of action existed under the embedded federal statute. *See* Brief of *Amici Curiae* Jerome R. Mikulski *et ux.* in Support of Petitioner at 3, *Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfg.*, 545 U.S. 308 (2005) (No. 04-603), 2005 WL 1333265. Under respondents' proposed test, federal jurisdiction would have been improper in both cases because neither statute created a private right of action. *See id.* at 1-3. However, once this Court rejected a bright-line rule, any similarities between *Grable* and the present case dissipated given the starkly different state-law claims and embedded federal issue.

this case – will be increasingly unlikely to occur in the future. *See id.* at 34a-35a. In light of those objective facts, and contrary to petitioners' contention, there is nothing "subjective" or "speculative" about the court of appeals' determination that the federal issue in this case is not substantial. *See* Pet. 14, 19.[6]

Petitioners assert that "construction of federal law will control the outcome of the case." Pet. 12. That is incorrect. As explained above, to succeed on the merits, respondents must prevail on much more than their interpretation of § 312(n)(1)'s effective-date provision. *See Fifth Third Bank*, 835 N.E.2d at 787-88 (setting forth elements of fraudulent-misrepresentation claim); *Lawrence*, 713 N.E.2d at 480 (setting forth elements of breach-of-contract claim).[7] In *Empire*, this Court distinguished *Grable* on the basis that the reimbursement claim triggered by settlement of a personal-injury action in *Empire* was a far cry from the "nearly pure issue of law" faced by the Court in *Grable*. 547 U.S. at 700 (internal quotation marks omitted). As the Seventh Circuit recognized in applying *Empire* and *Grable*,

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[6] For these same reasons, the Chamber of Commerce's concern that a state court decision on this discrete, unusual federal tax issue will create an incentive problem for businesses is overblown. *See* Chamber of Commerce Br. 14-15. And, to the extent the Chamber of Commerce suggests that policy concerns weigh against permitting *any* litigation over tax misreporting, Congress disagrees. In 26 U.S.C. § 7434, Congress provided a right of action for the exact type of tax misreporting alleged here. *See infra* p. 23.

[7] The Tax Foundation also seems to misapprehend the elements of respondents' claims, as its brief *amicus curiae* is premised on the idea that "the suit raises precisely the same issues that would have to be litigated in a tax refund claim" involving the IRS. Tax Foundation Br. 8.

federal jurisdiction is improper when (as here) the case involves "a fact-specific application of rules that come from both federal and state law rather than a context-free inquiry into the meaning of a federal law" and "[s]tate issues, such as the amount of damages, may well predominate." *Bennett v. Southwest Airlines Co.*, 484 F.3d 907, 910 (7th Cir. 2007) (Easterbrook, J.).

Petitioners also assert that federal jurisdiction would not disrupt the federal-state balance of judicial responsibilities "because Congress itself commanded that suits seeking to recoup overpaid federal taxes must be litigated in a federal forum." Pet. 13. But, as explained in greater detail in Part II, *infra*, this case is far from a suit "seeking to recoup overpaid federal taxes." Respondents' position is that the IRS correctly assessed tax liability using the (false) information provided by petitioners on Forms 1099-DIV. Respondents' claim is that, but for petitioners' *misrepresentations* on the Forms 1099-DIV – a garden-variety state common-law claim – their tax liability would have been lower. Thus, Congress's decision to allow claims for tax refunds *from the federal government* to be litigated in federal court has no bearing on the propriety of federal jurisdiction in this case. Moreover, as this Court stated in *Empire*, "[t]he state court in which the [tort] suit was lodged is competent to apply federal law, to the extent it is relevant." 547 U.S. at 701.

In addition, no basis exists for petitioners' fear that allowing the Ohio courts to adjudicate respondents' claims will allow petitioners to be "whipsawed between state-court liability and federal directives." Pet. 17-18 (citation omitted). If petitioners believe that a judgment holding them liable for the mis-

conduct alleged here would conflict with federal law, they are free to raise a preemption defense in the state proceedings. But it is "settled law that a case may *not* be removed to federal court on the basis of a federal defense, including the defense of preemption." *Caterpillar Inc. v. Williams*, 482 U.S. 386, 393 (1987).

Furthermore, the existence of such a conflict is exceedingly unlikely, considering that no court – *state or federal* – has previously interpreted § 312(n)(1). If conflicting interpretations of entities' reporting obligations under that provision were to arise, however, the IRS could issue regulations or interpretive memoranda to resolve the issue. And this Court retains the ability to ensure the uniform interpretation of federal law through its certiorari jurisdiction. *See Merrell Dow Pharms. Inc. v. Thompson*, 478 U.S. 804, 816 (1986) (emphasizing that any "concern about the uniformity of interpretation [by state courts] is considerably mitigated by the fact that, even if there is no original district court jurisdiction for these kinds of action, this Court retains power to review the decision of a federal issue in a state cause of action").

By arguing that "*Grable* establishes that federal 'arising under' jurisdiction is proper in . . . tax cases," Pet. 10, petitioners in effect urge this Court to interpret *Grable* as categorically providing for federal jurisdiction over *every* state-law claim requiring interpretation of *any* provision of federal tax law. But that contention cannot be reconciled with *Grable*, in which the Court emphasized the need for a case-by-case assessment of the propriety of asserting federal jurisdiction, lest an expansive interpretation of federal jurisdiction disturb the congressionally imposed

division of labor between the state and federal courts embodied in § 1331's well-pleaded-complaint rule. *See Grable*, 545 U.S. at 313-14.

B. There Is No Conflict in the Circuits.

Petitioners contend that several courts of appeals have rendered decisions that conflict with the decision below. That is incorrect. In each of the cases petitioners cite, the court of appeals acknowledged that *Grable* articulates the governing standard and applied the doctrine described in that case to the specific federal questions and state-law claims at issue in the case before it.[8] Legal and factual differences in each case led the circuit courts to conclude varyingly that federal jurisdiction was, or was not, appropriate in that particular instance. Critically, none of the cases petitioners cite involved a claim remotely similar to the one at issue here. Moreover, none of the courts of appeals mentioned the other cases involved in the purported split or suggested that any tension exists in the circuit decisions applying *Grable*. The "conflict" therefore is wholly imagined by petitioners.

In *Nicodemus*, the United States had a direct interest in the outcome of the proceedings. The plaintiff's various state-law claims hinged entirely on the scope of the Union Pacific railroad's right-of-way, which was obtained pursuant to the federal land-grant statutes. *See* 440 F.3d at 1234. The property subject to the right-of-way will revert to

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[8] *See Immunocept, LLC v. Fulbright & Jaworski, LLP*, 504 F.3d 1281, 1284 (Fed. Cir. 2007); *Air Measurement Techs., Inc. v. Akin Gump Strauss Hauer & Feld, LLP*, 504 F.3d 1262, 1267, 1271-72 (Fed. Cir. 2007); *Nicodemus v. Union Pac. Corp.*, 440 F.3d 1227, 1231-32, 1235-36 (10th Cir. 2006); *Broder v. Cablevision Sys. Corp.*, 418 F.3d 187, 194-95 (2d Cir. 2005).

the United States when Union Pacific ceases using the property for railroad purposes. *See id.* at 1236. The Tenth Circuit concluded that, under *Grable*, the government's property interest rendered the federal issue in the case "substantial." *See id.* The court also determined that its decision would minimally affect the state-federal judicial balance because it will "be the rare state trespass and unjust enrichment case that so uniquely turns on a critical matter of federal law." *Id.* at 1237.

The state-law claims in *Broder* required a court to analyze "the complex federal regulatory scheme applicable to cable television rates." 418 F.3d at 195. Section 623(d) of the Communications Act of 1934 requires a cable operator not subject to "effective competition" to provide a "rate structure . . . that is uniform throughout the geographic area in which cable service is provided over its cable system." 47 U.S.C. § 543(d). The court would thus be required to determine, among other things, the plaintiff's "geographic area" and whether that geographic area was subject to "effective competition" – both of which would be governed by federal law. Under those circumstances, the Second Circuit perceived "'a serious federal interest in claiming the advantages thought to be inherent in a federal forum.'" 418 F.3d at 195 (quoting *Grable*, 545 U.S. at 313). The court also reasoned that exercising federal jurisdiction posed no risk to the state-federal judicial balance because it would be "rare" for a plaintiff bringing a breach-of-contract or deceptive-trade-practices claim under New York law "to assert a private right of action for violation of a federal law otherwise lacking one." *Id.* at 196.

Finally, *Air Measurement* and *Immunocept* (companion cases decided on the same day) are inapposite because the Federal Circuit's analysis focused on *Christianson v. Colt Industries Operating Corp.*, 486 U.S. 800 (1988) – a case that turned on the meaning of the statute providing for exclusive federal jurisdiction of all matters "relating to patents," 28 U.S.C. § 1338(a). Both of those cases involved legal malpractice claims against counsel who had allegedly injured the plaintiffs through negligent preparation of patent applications.[9] Both cases required the trial court to engage in a patent claim construction analysis, *see Markman v. Westview Instruments, Inc.*, 517 U.S. 370 (1996), as a necessary element of the underlying malpractice claim. *See Immunocept*, 504 F.3d at 1285; *Air Measurement*, 504 F.3d at 1268-69. The Federal Circuit carefully applied *Christianson*, "in view of the federalism concerns of *Grable*," to the facts of each case. *Immunocept*, 504 F.3d at 1284; *see Air Measurement*, 504 F.3d at 1267-68. The court concluded that any patent issue embedded in a state-law claim is categorically "a substantial question of federal patent law," *Christianson*, 486 U.S. at 809, that supports federal jurisdiction, relying on Congress's grant of exclusive federal jurisdiction in § 1338(a) and its establishment of the Federal Circuit to promote uniformity in the patent law, *see* Federal Courts Improvement Act of 1982, Pub. L. No. 97-164,

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[9] *See Immunocept*, 504 F.3d at 1283 (patent claim language used by counsel provided inadequate protection, causing Johnson & Johnson to terminate negotiations to commercialize the invention); *Air Measurement*, 504 F.3d at 1266 (inventors were forced to settle infringement suits below fair market value because attorney delay and omissions enabled defendants to argue on-sale bar to patentability, *see* 35 U.S.C. § 102(b), and inequitable conduct).

96 Stat. 25. *See Immunocept*, 504 F.3d at 1285-86; *Air Measurement*, 504 F.3d at 1269. The Federal Circuit explained that its ruling was consistent with *Grable* because "Congress considered the federal-state division of labor and struck a balance in favor of this court's entertaining patent infringement." *Air Measurement*, 504 F.3d at 1272.

Nothing in those cases supports petitioners' supposition that the Second, Tenth, or Federal Circuit would have reached a different result had they addressed the claim in this case. Indeed, the opposite appears true: federal district courts applying those precedents have denied federal jurisdiction over claims similar to those in this case. *See*, *e.g.*, *Elmira Teachers' Ass'n v. Elmira City Sch. Dist.*, No. 05-CV-6513 CJS, 2006 U.S. Dist. LEXIS 3893, at *15-*18 (W.D.N.Y. Jan. 27, 2006) (applying *Broder* and granting motion to remand to state court where state-law breach-of-contract and negligence actions alleged violation of 26 U.S.C. § 403(b), and where damages would be measured by tax consequences for that violation); *Callahan v. Countrywide Home Loans, Inc.*, No. 3:06cv105/RV/MD, 2006 U.S. Dist. LEXIS 42860, at *7-*9 (N.D. Fla. June 26, 2006) (applying *Nicodemus* and concluding no federal-question jurisdiction existed over plaintiff's claim that insurer was negligent in failing to comply with the National Flood Insurance Act of 1968, 42 U.S.C. § 4011 *et seq.*, and explaining that "[a]llowing federal question jurisdiction over all state law negligence claims that incorporate a federal duty could potentially flood the federal docket with cases based on a violation of a federal statute"); *Caggiano v. Pfizer Inc.*, 384 F. Supp. 2d 689, 691 (S.D.N.Y. 2005) (applying *Broder* and granting motion to remand to state court claims

alleging violation of various federal statutes and regulations, and explaining that "[t]he duties alleged to have been breached here are not creatures of federal law . . . ; rather, federal standards merely inform the content of classically state-law duties such as avoiding negligence and fraud").

Moreover, and in any event, *Grable* and *Empire* are quite recent decisions of this Court, and the courts of appeals have only begun to apply their holdings. Indeed, two of the cases cited by petitioners in the purported circuit split pre-date *Empire*. To the extent that any inconsistencies exist in the case law, they are inchoate and would benefit from further percolation before undergoing review by this Court.

That is especially so in light of Congress's subsequent enactment of 26 U.S.C. § 7434, which provides a federal right of action for the exact type of tax misreporting alleged here and thus eliminates the continuing importance of the question presented. Under § 7434(a), "[i]f any person willfully files a fraudulent information return with respect to payments purported to be made to any other person, such other person may bring a civil action for damages against the person so filing such return." Respondents' allegation – that petitioners fraudulently misreported the amount of dividends on Forms 1099-DIV – falls squarely within that statutory language. Thus, in the unlikely event that a state-law claim like respondents' were to arise again, the question would be whether § 7434 completely preempts the claim. The issue presented in this petition therefore lacks any continuing importance, rendering certiorari inappropriate for that reason as well.

II. The Sixth Circuit's Understanding of § 7422 Was Correct and Consistent with the Decisions of Other Courts of Appeals.

Petitioners also claim that certiorari should be granted to review whether 26 U.S.C. § 7422 completely preempts state-law tort and contract claims between private parties for which tax-related injuries are recoverable as consequential and compensatory damages. *See* Pet. 24-26. But further review of that question is likewise unwarranted. This Court has explained that complete preemption is quite rare, found only in circumstances not present here. And the cases petitioners assert conflict with the decision below all involve the same type of claim – one that is fundamentally different from the claim at issue here.

A. The Court of Appeals Correctly Applied *Beneficial National Bank* to the Facts of this Case.

Unlike an ordinary preemption defense, which can be pleaded in state court proceedings, the doctrine of complete preemption is jurisdictional and provides an exception to the well-pleaded-complaint rule. In *Beneficial National Bank v. Anderson*, 539 U.S. 1 (2003), this Court explained that a federal statute "completely pre-empts" a state-law claim, and thereby creates a basis for removal jurisdiction, only when "the federal statute[] at issue provide[s] the exclusive cause of action for the claim asserted and also set[s] forth procedures and remedies governing that cause of action." *Id.* at 8. In that case, the Court held that the National Bank Act completely preempts state-law usury claims against national banks. It relied on "this Court's longstanding and consistent construction of the National Bank Act as providing an exclusive federal cause of action for usury against national

banks," as well as the Court's cases recognizing "the special nature of federally chartered banks." *Id.* at 10.

In addition to *Beneficial National Bank*, this Court has found complete preemption only twice, in cases involving claims arising under the Labor-Management Relations Act, 1947 (LMRA), 29 U.S.C. § 185, and the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq.* In those cases, the Court relied, respectively, on "the unusually 'powerful' pre-emptive force of § 301 [of the LMRA]," *Beneficial Nat'l Bank*, 539 U.S. at 7 (citing *Avco Corp. v. Aero Lodge No. 735*, 390 U.S. 557 (1968)), and the "unambiguous[]" legislative history of ERISA, *see id.* at 7-8 (citing *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S. 58 (1987)).

Applying *Beneficial National Bank*, the Sixth Circuit held unanimously that § 7422 does not completely preempt the Mikulskis' claims. *See* Pet. App. 16a-20a. Section 7422 provides that, as a prerequisite to bringing a lawsuit, an aggrieved taxpayer seeking "recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected" must file an administrative claim for a refund. 26 U.S.C. § 7422(a). After the claimant exhausts that administrative remedy, suits "may be maintained only against the United States." *Id.* § 7422(f)(1).

Section 7422 does not provide the "exclusive cause of action" (*Beneficial Nat'l Bank*, 539 U.S. at 9) for respondents' claims because they do not allege that a tax has been "erroneously or illegally assessed or collected" (26 U.S.C. § 7422(a)). To the contrary, respondents' position is that the IRS correctly calculated the amount of tax due using the (false) infor-

mation provided by petitioners on Forms 1099-DIV. As the court of appeals explained, "[u]nder the plaintiffs' theory, the IRS was an innocent third-party, who, like the plaintiffs themselves, merely relied on the 1099-DIVs issued by Centerior, while Centerior" – which knowingly provided false information in the forms – "was the active (i.e., liable) tortfeasor." Pet. App. 19a.

Moreover, even if respondents could have filed refund claims with the IRS, that administrative procedure is not equipped to handle a categorical determination affecting thousands of individual shareholders' tax returns spanning multiple tax years. Refund claims are specific to the particular taxpayer and tax year at issue, and will not resolve the same issue for different taxpayers or for a subsequent (or previous) tax year. *See*, *e.g.*, *BCS Fin. Corp. v. United States*, 118 F.3d 522, 524-25 (7th Cir. 1997) ("[T]o claim a refund for 1981 is not to claim a refund for 1984, even if the logic underlying the 1981 claim would suggest to a person knowledgeable about tax law and the affairs of the taxpayer that the taxpayer would also have a claim for 1984."); *Rose v. American Airlines, Inc.*, 331 F. Supp. 77, 79 (N.D. Ill. 1971) (explaining that each individual who paid tax must file separate refund claim with IRS and rejecting plaintiff's attempt to file administrative claim for "class" refund).

Thus, under the IRS administrative refund procedure, each shareholder would have to file a return-specific claim for each tax year in which his Form 1099-DIV was inaccurate – leading to potentially hundreds of thousands of claims, given the number of shareholders and number of tax years in which petitioners' accounting practices are at issue. Congress

could not have intended the IRS administrative refund system to be the exclusive recourse for the type of claims raised by respondents: as this Court has stated, "there would be serious question about the reasonableness of a system that forced a [taxpayer] to bring a series of backward-looking refund suits in order to establish repeatedly the legality of [a] claim." *Bob Jones Univ. v. Simon*, 416 U.S. 725, 748 n.22 (1974).

B. The Sixth Circuit's Analysis Is Consistent with Other Courts of Appeals.

The cases on which petitioners rely all arise from a series of class-action suits brought in the mid-1990s involving airlines' collection of a 10-percent federal excise tax on domestic air transportation. *See Brennan v. Southwest Airlines Co.*, 134 F.3d 1405, *as amended*, 140 F.3d 849 (9th Cir. 1998); *Sigmon v. Southwest Airlines Co.*, 110 F.3d 1200 (5th Cir. 1997); *Kaucky v. Southwest Airlines Co.*, 109 F.3d 349 (7th Cir. 1997). Federal law required all airline passengers to pay a 10-percent excise tax on domestic air travel commenced on or before December 31, 1995. *See* 26 U.S.C. § 4261 (1994). The airlines were required to collect the tax from customers and remit it twice monthly to the IRS. *See id.* § 4291; 26 C.F.R. § 40.6302(c)-1(b)(1)(i) (1995). Although the tax expired on December 31, 1995, the airlines collected the tax from all passengers who purchased tickets in 1995, even if a passenger was not scheduled to travel until 1996. Passengers who paid the tax in 1995 on tickets for travel in 1996 initiated several class-action suits against the airlines to recover the wrongfully assessed tax.

The courts of appeals uniformly held that § 7422 completely preempted plaintiffs' claims. Because the

plaintiffs in those cases sought "recovery of . . . [a] tax alleged to have been erroneously" collected, they were required to comply with § 7422, and the fact that the tax was collected on behalf of the IRS by a third party did not affect that conclusion. *See Brennan*, 134 F.3d at 1413; *Sigmon*, 110 F.3d at 1204; *Kaucky*, 109 F.3d at 351-52.

Petitioners here were not "the Internal Revenue Service's 'collection agent,'" as were the defendants in *Brennan*, *Sigmon*, and *Kaucky*. *E.g.*, *Kaucky*, 109 F.3d at 351. The federal government did not impose on petitioners a duty to collect taxes, nor did petitioners collect taxes from respondents. On the contrary, petitioners agreed in contracts with their shareholders to *report* dividend information in conformity with federal law. Petitioners breached their state common-law and contractual duties to report accurate dividend information and thereby increased the amount of taxes that *respondents paid* to the IRS. Respondents are thus not attempting to "whipsaw[]" a government agent, *id.* at 353, but rather seek recovery from a corporation that misrepresented information to its shareholders and the IRS.

Moreover, the plaintiffs in the airline tax cases sought to recover the *actual tax paid*. Here, in contrast, respondents do not seek recovery of the actual tax paid to the IRS because, as explained above, they do not contend that the tax was improperly assessed. Rather, respondents assert that they paid excessive taxes – both state and federal – because petitioners made fraudulent misrepresentations and breached their obligation under the shareholder agreements to determine and report dividends accurately. A person who has suffered loss from fraud or misrepresentation may recover not only general damages, but also

damages from any "added tax burdens." 2 Dan B. Dobbs, *Law of Remedies* § 9.2(3), at 557 (2d ed. 1993). Simply treating an increased tax burden as an element of damages recoverable under state law does not convert quintessentially state-law claims into a claim for a federal tax refund.[10]

Conclusion

The petition for a writ of certiorari should be denied.

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[10] Finally, and in all events, remand of one of the four cases that was consolidated in this appeal is required because petitioners' notice of removal in that case was untimely. Section 1446(b) requires a defendant to file a notice of removal within 30 days of receiving the complaint, unless "the case stated by the initial pleading is *not* removable," in which case "a notice of removal may be filed within thirty days after the receipt by the defendant . . . of a . . . paper from which it may *first* be ascertained that the case is" removable. 28 U.S.C. § 1446(b) (emphases added). Petitioners filed their notice of removal in the first case 11 months after service of the complaint, and they contend that removal was timely because respondents first named § 312(n)(1) as the precise federal tax provision under which petitioners incorrectly calculated E&P in a supplemental interrogatory response. But, if this proceeding was removable at all, the basis of removal was apparent in respondents' complaint, which is replete with references to the Internal Revenue Code and terms specifically defined therein. *See*, *e.g.*, Compl. ¶¶ 24, 29-32, *quoted at* Pet. App. 12a-14a. Petitioners' failure to comply with the statutory time limit for removal provides an independent basis for sustaining the court of appeals' judgment as to the first case.

Respectfully submitted,

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