No. G041338

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
FOURTH APPELLATE DISTRICT
DIVISION THREE

PRICELINE.COM, INC., et al.
Plaintiffs and Appellants,

v.

CITY OF ANAHEIM, et al.
Defendant and Respondent.

Appeal from the Superior Court of the State of California for the County of Orange
Hon. Ronald L. Bauer, Judge
Trial Court Case No.: 30-2008-00180048

BRIEF *AMICUS CURIAE* OF THE TAX FOUNDATION IN SUPPORT OF PLAINTIFFS/APPELLANTS

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CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

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INTEREST OF THE *AMICUS CURIAE*

The Tax Foundation is a non-partisan, non-profit research institution founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., the Foundation's economic and policy analysis is guided by the principles of neutrality, simplicity, transparency, and stability. The Tax Foundation makes information about government finance more understandable, such as with its annual calculation of "Tax Freedom Day," the day of the year when taxpayers have earned enough to pay for the nation's tax burden and begin earning for themselves.

The Tax Foundation educates the legal community and the general public about economics and taxpayer protections and advocates that judicial and policy decisions on tax law promote principled tax policy. Recent federal and state tax-related cases in which the Tax Foundation has participated as *amicus curiae* include *Department of Revenue of Kentucky v. Davis*, 128 S. Ct. 1801 (2008); *CSX Transportation, Inc. v. Georgia State Board of Equalization*, 128 S. Ct. 467 (2007); *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332 (2005); *Bonner v. Indiana*, No. 49S02-0809-CV-525 (Ind. 2008); *Ardon v. City of Los Angeles*, 174 Cal. App. 4th 369 (2009), and

Weisblat v. City of San Diego (No. D052787) (pending before the Court of Appeal, Fourth Appellate Division).

This case involves an important issue of tax policy. By addressing the use of contingency fee attorneys as part of the tax law enforcement process, the opinion of this Court will not only have an impact on the largest State in the Union, but its rationale will likely aid other states confronting similar questions. The Tax Foundation is in a unique position to aid this Court because it has conducted extensive research into tax collection practices and past experiences, and this research directly goes to the question of the circumstances under which contingency fee counsel can be under the full control over tax law enforcement litigation. Accordingly, the Tax Foundation has an institutional interest in this case.

STATEMENT OF THE CASE

Appellants, online travel companies (OTCs), are challenging the use of contingency fee attorneys by the Respondent, the City of Anaheim ('Anaheim' or 'city'). They allege that the use of contingency fee attorneys violates a duty of absolute neutrality that the city must maintain in enforcing its tax laws. The Appellants base their argument on *Clancy v. The Superior Court of Riverside County*,

39 Cal. 3d 740 (1985). In reply, the respondents argue that *Clancy*'s duty of "absolute neutrality," if it applies to tax enforcement proceedings, may be satisfied if the city maintains "full control" over the litigation and its contingency fee attorneys. *City and County of San Francisco v. Philip Morris, Inc.*, (N.D. Cal. 1997) 957 F. Supp. 1130, 1135. The Respondents argue that the city has maintained such "full control," while the appellants argue to the contrary, claiming that the contingency fee attorneys have acted too autonomously based on their financial interest in the outcome of the case.

SUMMARY OF ARGUMENT

The recent failure of the IRS's Private Debt Collection program reveals that when private interests receive a stake in the administration of inherently governmental functions, it is extremely difficult to maintain full control over private actors in their quasi-governmental role. The IRS made ardent attempts to oversee the private collection agencies, with the aim of ensuring that the collection agencies' interest in collecting as much money as possible to increase their contingency commission did not unduly influence their tax collection procedures. Nevertheless, it did; some of the agencies employed self-serving techniques aimed at collecting the most tax debt possible

rather than reaching the most effective and neutral governmental resolution. This failure suggests that for Anaheim to achieve "full control" over its contingency fee attorneys, its control mechanisms would have to provide nearly flawless oversight.

If this Court determines a control exception exists to the duty of absolute neutrality and that the City's efforts are akin to mere tax collection, this Court should be skeptical about the City's claim that it has maintained "full control" over its contingency fee attorneys. This Court should be exceptionally critical in examining the city's oversight procedures since the appellants' allegations of bias suggest that Anaheim has not exercised "full control" and, if it is imposed, has violated its absolute duty of neutrality.

ARGUMENT

I. WITHOUT FLAWLESS OVERSIGHT, GOVERNMENTS LIKE THE CITY OF ANAHEIM CANNOT ASSURE THE ABSOLUTE NEUTRALITY OF THEIR CONTINGENCY FEE ATTORNEYS NOR MAINTAIN FULL CONTROL OVER THEM.

A. Recent Experience With Tax Collection By Private Debt Collectors Reveals Serious Problems Even With Significant Oversight Protections.

In September 2006, the Internal Revenue Service (IRS) initiated its Private Debt Collection program, contracting with private debt

collection agencies on a contingency fee basis to collect tax debts for the United States. *See, e.g.*, National Taxpayer Advocate, *2006 Annual Report to Congress*, p. 34, http://www.irs.gov/pub/irs-utl/2006_arc_vol_1_cover__section_1.pdf [hereinafter *2006 National Taxpayer Advocate Annual Report*]; National Taxpayer Advocate, *2005 Annual Report to Congress*, p. 83, http://www.irs.gov/pub/irs-utl/section_1.pdf (outlining contingency fee agreement) [hereinafter *2005 National Taxpayer Advocate Annual Report*]. As an inherently governmental function requiring discretionary application of federal tax laws to collect federal funds, tax collection may not be delegated or outsourced to private parties. *See* Federal Activities Inventory Reform Act of 1998, Pub. L. No. 105-270, §5(2)(A), 112 Stat. 2382, 31 U.S.C. §501 nt. 31 (establishing that inherently federal governmental functions may not be outsourced to private parties); *id.* at §5(2)(B)(v) (establishing that tax collection is an inherently governmental function). Discretion in the matter may only be exercised by federal employees lawfully authorized to do so. *See id.* at §5(2)(A).

The IRS, as the agent authorized by the United States to exercise this discretion, determines whether tax collection proceedings should be

initiated or terminated and makes "value judgments" about the enforcement of the tax laws. *See* Hearing on Internal Revenue Service's Use of Private Debt Collection Companies to Collect Federal Income Taxes Before the H. Comm. on Ways and Means, 110th Cong. 110-43 (2007) (statement of Nina E. Olson, National Taxpayer Advocate, Internal Revenue Service), pg. 3, *available at* http://www.irs.gov/pub/irs-utl/ntatestimony_wm_pdc_052307.pdf [hereinafter Olson Testimony]. As explained by Nina Olson, the current National Taxpayer Advocate at the IRS, to do this properly, the IRS must neutrally approach tax disputes and pursue an equitable settlement, possibly for less money than the United States is entitled to receive if the settlement otherwise best serves the public good. *See id.* 24 (stating that IRS collection efforts are 'compliance-based,' not performance based); *see also 2006 National Taxpayer Advocate Report* at 50-51 (stating that the IRS applies a 'long-term approach to tax administration').

Because of the universal understanding that exercises of discretion may not be delegated to private contractors by the IRS, the private debt collection program was built around the idea that private parties could effectively collect taxes in cases that did not involve

such governmental decision-making. *See 2006 National Taxpayer Advocate Report* at 36-38 (explaining why the collection agencies' caseload would not be inherently governmental work if completed by private parties). The thinking was that the collection agencies would only be assigned "easy" cases that did not involve disputed facts or underlying personal circumstances that would necessitate the exercise of governmental discretion to resolve. *See National Taxpayer Advocate's FY 2006 Objectives Report to Congress*, p. 10 http://www.irs.gov/pub/irs-utl/2006junereportfinal.pdf; *see also* Olson Testimony at 4 (pointing out that it was not believed that the easy cases involved 'the exercise of judgment or discretion'). In fact, it was believed that a significant number of cases could "be resolved by making one or more phone calls to the taxpayer." National Taxpayer Advocate *2007 Annual Report to Congress*, p. 415, http://www.irs.gov/pub/irs-utl/arc_2007_vol_1_cover_msps.pdf..

These hopes proved to be illusory in practice. The Private Debt Collection program was ultimately discontinued because it was more effective for the IRS to resolve tax collection disputes directly. Internal Revenue Service Document: IR-2009-019, IRS conducts Extensive Review, Decides Not to Renew Private Debt Collection

Contracts (March 6, 2009). The IRS concluded that a primary reason for the poor performance was because government employees "have a range of options available to them in attempting to resolve difficult collection cases that, by law, the [collection agencies did] not have." *Id.* The IRS in practice had difficulty finding cases "easy" enough not to require the exercise of governmental discretion. Olson Testimony at 10. Nina Olson even went so far as to argue "that there [was] no such thing as a simple tax case." Interview with Nina Olson, National Taxpayer Advocate at the IRS, Tax Foundation: Tax Policy Podcast (Sept. 19, 2006), http://www.taxfoundation.org/blog/show/1848.html. Most cases involved special circumstances or disputes that simply "[could not] be delegated to a non-governmental employee," because they "[required] the exercise of judgment and discretion" that only the IRS had the authority to apply. Olson Testimony at 11.

It is true that the private collection agencies were instructed to refer "difficult" cases back to the IRS, particularly in cases where it was clear that compromise or termination of the debt may be appropriate resolutions. *See id.* at 12-13; *see also 2005 National Taxpayer Advocate Report* at 81-82. (outlining that the collection agencies were required to refer taxpayers alleging economic hardship

back to the IRS). While the IRS stated that its decision to discontinue the program was not based on performance of private debt collectors, evidence has emerged indicating that some of those collectors deliberately avoided referring taxpayers back to the IRS. *See* Olson Testimony at 13 (providing "examples where the [private collection agencies] continued pressuring the taxpayer into paying rather than answering the taxpayer's question or making a referral to the IRS Referral Unit."). Because the private collectors' objective was simply "secur[ing] payment from…taxpayer[s] and collect[ing] their commission," they were reluctant to lose that commission by referring taxpayers back to the IRS. *See id.* at 13-14. Collection was done primarily with the use of calling scripts aimed at pressuring taxpayers into immediately remitting their payment, regardless of their individual circumstances. *See id.* at 15-16. Taxpayers were not made aware of their ability to reach out to the IRS for discretionary consideration. *See 2006 National Taxpayer Advocate Report* at 49.

These practices occurred despite "[a]ggresive oversight and effective management" implemented by the IRS. National Taxpayer Advocate 2008 Annual Report to Congress, pg. 334 http://www.irs.gov/pub/irs-utl/08_tas_arc_intro_toc_msp.pdf [hereinafter 2008

Report]. From the beginning, the IRS and officials recognized that protective measures were required to ensure that the private collection program would not "diminish the respect that most U.S. taxpayers have for our tax system." *2005 National Taxpayer Advocate Report* at 89. To implement this management and regulation, the IRS mobilized: (1) a taxpayer complaint process, *id.* at 82; (2) ongoing reviews of private collector actions, *id.* at 90; (3) rules regulating referrals back to the IRS in cases where taxpayers were found to be unable to pay, *id.* at 81; (4) a dispute appeals process, *id.* at 87; (5) comprehensive training materials, *id.* at 90; (6) active regulation of private collector training programs, *id.* at 89; (7) direct oversight by IRS employees meant to ensure that cases were handled properly, *id.* at 90; and (8) active procedural and legal review of the private collection processes, *2006 National Taxpayer Advocate Report* at 56.

Even with these checks and balances, the inherent nature of the program resulted in delegation of decision-making lawfully reserved only to government officials, pitting a desire for commissions against the public good. Taxpayers were deprived of neutral discretion in their disputes. The program's abuses were widely documented, and its ineffectiveness sealed its fate. Unable to reform the private collection

program in a way that effectively reserved discretion to IRS officials, the program was terminated.

B. The City's Use of Contingency Fee Counsel Will Encounter the Same Problems that the IRS Debt Collection Program Encountered.

Appellants argue that California law dictates that an absolute neutrality must be maintained by governments when prosecuting violations of tax law, and that the Appellees' use of contingency fee counsel violates that neutrality. (*See* Appellants Br. at 30, 34.) The basis of Appellants' argument is *Clancy v. Superior Court of Riverside County*, 39 Cal. 3d 740 (1985). (*See id.* at 39.) They argue that tax enforcement proceedings are among "a class of civil actions" in California demanding absolute neutrality and therefore prohibiting the use of contingency fee attorneys. (*See id.* at 30); *see also Clancy v. Superior Court of Riverside County*, (1985) 39 Cal. 3d 740, 748. This is because the exercise of sovereign discretion is needed to reach a just balance between public and private interests. (*See* Appellants Br. at 32; *see also* Appellants Reply Br. at 21.)

The City argues that by exercising "full control over" its contingency fee attorneys, it can effectively keep their private interests in check. (*See* Appellees Br. at 20-21); *see also City and*

County of San Francisco v. Philip Morris, Inc., (N.D. Cal. 1997) 957 F. Supp. 1130, 1135 (stating that sufficient control neutralizes the fears of 'overzealousness' expressed in *Clancy*). The Appellants challenge this argument, alleging that a "control exception" does not exist. (Appellants Br. at 45.) Here, the City argues that it maintains "full control over" its contingency fee attorneys because (1) a city attorney acts as a "representative to direct" the litigation, (2) any substantive legal decisions require approval of the city, (3) settlements require approval of the city; and (4) the city's audit manager approves tax assessments. (Appellees Br. at 21-23.)

While the City's design of the program may be entitled to deference, deference is not absolute. The experience of the IRS private debt collection program reveals that even ardent attempts to preserve government neutrality while using private tax collectors failed. The parties and the Court must carefully review the methods by which the City seeks to manage their contingency fee attorneys, and whether or not they worked for the IRS.

Both the IRS then and the City now claim that they directly supervise the private parties' work, maintain ultimate authority over significant decisions, and assign the private parties limited roles in

conducting governmental functions. Nevertheless, private debt collectors managed to undermine the IRS' desired neutral administration of tax collection because the program's inherent nature pitted private profit against their role as a neutral substitute for the IRS. *See* Olson Testimony at 13-14, 15-16 (citing the use of scripts and persuasive techniques). They had no motivation to be neutral and their contingency fee provided the perfect incentive not to be.

Here, Appellants allege that the city's contingency fee attorneys undermine the neutral administration of tax laws due to insufficient or ineffective city oversight, leading to the private attorneys having too much autonomy over what should be discretionary governmental decisions. They argue that the contingency fee attorneys' private interests have driven the litigation, influencing the initiation of the tax proceedings, (Appellants Br. at 1); controlling them from the beginning, (*id.* at 14); conducting the administrative process, (*id.* at 14-15); estimating the Appellants' tax debt, (*id.* at 15); and serving as the exclusive spokesperson of the Appellees, (*id.* at 15.) This Court should not lightly dismiss these allegations, as they strongly resemble problems that emerged with the IRS' similar program. Further, while the IRS sought to limit private collection agencies to "easy" cases

requiring no discretion, the same cannot be said for the City's use of contingency fee counsel involved in the complex, novel application of Anaheim's tax law.

Should this Court conclude that the City may use contingency fee counsel provided that it exercises "full control" over them, this Court's primary inquiry will be whether the City's oversight mechanisms were sufficient to provide that neutrality. Based on the experience of the IRS with its private debt collection program, however, it is difficult to conceive how a contingency fee attorney program can be structured to ensure sufficient control. Absolute control, even with exceptional oversight, escaped the reach of the IRS. The City's efforts to prevent the contingency fee attorneys from acting as government employees in all but name should be nearly flawless, and should be evaluated from that perspective.

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests that the decision of the Court below be reversed. This Court should evaluate the effectiveness of the City's oversight practices against the failed oversight of the IRS's private debt collection program. If the Court concludes that the City's efforts have in any way permitted the

contingency fee attorneys to drive the litigation or make discretionary decisions reserved to government officials, the Court should conclude that the requisite flawless oversight has not occurred.

This the 25th day of June, 2009.

Respectfully submitted,

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WORD CERTIFICATION

I, Edward M. Teyssier, counsel of record for *Amicus* Tax Foundation, hereby certify that according to Microsoft Word, the computer program used to prepare this Brief *Amicus Curiae* of Tax Foundation in Support of Plaintiffs/Appellants, the number of words in the document is 2,727, exclusive of captions, tables, signature block, and this certification.

Executed, this the 25th day of June, 2009, at National City, California.

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PROOF OF SERVICE

Case: *Priceline.com, Inc., et al. v. City of Anaheim, et al.*

4th Appellate District Civil Case No. G041338
County of Orange Superior Court Case No. 30-2008-00180048-CU-WM-CXC

I, Joseph Henchman, am over the age of eighteen years, and not a party to the within action. My business address is Tax Foundation, National Press Building, 529 14th Street, N.W., Suite 420, Washington, DC 20045-1000. On June 25, 2009, I served the within document:

TAX FOUNDATION'S BRIEF *AMICUS CURIAE* IN SUPPORT OF APPELLANTS

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