Mutual Fund Sales Notice Fees: Are A Handful of States Unconstitutionally Exacting $200 Million Each Year?

by DAVID M. GEFFEN[*]

Introduction

The National Securities Markets Improvement Act of 1996[1] ("NSMIA") preempted state regulations and registration requirements applicable to mutual funds,[2] thereby providing for exclusive federal jurisdiction over the operation of mutual funds and the contents of a mutual fund's prospectus.[3] At the same time, NSMIA preserved state antifraud authority with respect to local sales of mutual fund shares. NSMIA also preserved state authority to require mutual funds to file sales reports, indicating the value of shares sold or to be sold to persons located within the state, and to require mutual funds to pay filing fees in connection with the sales reports.

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1. National Securities Markets Improvement Act of 1996 ("NSMIA"), Pub. L. No. 104–290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.).

2. The discussion in this article is limited to federally registered open-end investment companies (mutual funds) and excludes companies that are exchange-traded funds.

3. The principal part of a registration statement is the prospectus. Therefore, for brevity, throughout this article, the term "prospectus" is used as shorthand for the mutual fund's registration statement.

Currently, every state, except Florida, requires mutual funds to file sales reports (hereinafter, "notice filings") and to pay filing fees with the notice filings (hereinafter, "notice filing fees"). A typical notice filing fee is based upon the value of the shares that a mutual fund sells to persons located in the state, subject to some annual maximum. In six states (hereinafter, "Premium Fee States"),[4] the notice filing fees paid by mutual funds are disproportionately greater than the notice filing fees paid by mutual funds to the remaining states. The Premium Fee States account for only 15 percent of the U.S. population. However, each year, the six Premium Fee States are paid approximately 50 percent, or about $200 million, of the total notice filing fees paid by mutual funds to all states.

This article examines the constitutional validity of the Premium Fee States' disproportionate notice filing fees. These fees are either state "regulatory fees"[5] or state taxes. The Commerce Clause[6] limits the power of the states to exact regulatory fees from interstate commerce, and both the Due Process Clause[7] and the Commerce Clause limit the power of the states to tax interstate commerce. This article concludes that, regardless of whether these fees are deemed to be state regulatory fees or state taxes, the Premium Fee States' notice filing fees are constitutionally invalid and, therefore, should be struck down.

Striking down the Premium Fee States' notice filing fees will have significant financial implications for mutual funds and their investors. Collectively, over the last three years, the Premium Fee States have unconstitutionally exacted approximately $600 million from mutual funds.[8] The funds may be able to recover roughly this amount from the Premium Fee States through negotiation or litigation. Prospectively, eliminating the annual $200-million unconstitutional exaction would be equivalent, in present value dollars, to a one-time savings by mutual funds of between $2 billion and $4 billion.[9]

4. The six states are: Texas, Washington, Minnesota, Wisconsin, Nebraska, and West Virginia.

5. A state imposes a regulatory fee to reimburse the state for costs incurred in regulating or policing a type of business or an activity. *See infra* notes 87–91 and accompanying text.

6. U.S. CONST. art. I, § 8, cl. 3.

7. U.S. CONST. amend. XIV, § 1.

8. *See infra* notes 66–67 and accompanying text.

9. *Id.*

The remainder of this article is organized as follows:

Part I explains the basic structure and operation of a mutual fund to show that, due to the way mutual fund shares are priced, a fund's expenses, which include notice filing fees, are borne dollar-for-dollar by the mutual fund's investors. Part I also explains why mutual funds, unlike publicly owned operating companies, are continuously selling their shares. This fact is important because the Premium Fee States' notice filing fees are based on the value of the shares sold by mutual funds.

Part II of this article describes the conflicts that arose in the late 1970s between state and federal regulation of mutual fund operations and share sales, and how these conflicts ultimately led to NSMIA's enactment.

Part III of this article analyzes the notice filing fee regimes in most states and compares these states to the Premium Fee States. Part III also presents the aggregate notice filing fees paid by mutual funds to each Premium Fee State in 2009, 2010, and 2011.

In Part IV and Part V, this article examines whether the Premium Fee States' notice filing fees are constitutionally valid. Part IV analyzes the notice filing fees as *regulatory fees* and concludes that these fees are constitutionally invalid under the Commerce Clause. Part V analyzes the Premium Fee States' notice filing fees as *state taxes* and concludes that these fees are constitutionally invalid on due process and Commerce Clause grounds.

In light of the combined length of Parts IV and V, Part VI of this article briefly summarizes the constitutional bases for rejecting the Premium Fee States' notice filing fees both as regulatory fees and as state taxes.

Finally, Part VII examines a variety of issues that mutual funds' advisers and boards of trustees or directors may want to consider in developing strategies to recover notice filing fees previously exacted unconstitutionally by the Premium Fee States, and to persuade the Premium Fee States to reduce their notice filing fees to adhere to constitutional requirements. The costs to recover previously paid fees, as well as the costs to obtain relief prospectively, may be prohibitive for any single family of mutual funds. The cost-benefit uncertainty is exacerbated by the fact that, if a single family of mutual funds were to succeed in obtaining compensation from a Premium Fee State, or in persuading a Premium Fee State to adhere to constitutional requirements, that success would benefit all competing mutual fund families. Therefore, a "free rider" collective action problem would arise. Among other issues, Part VII describes how this collective action problem can be resolved if all mutual funds rely on a single representative with the costs underwritten by all funds.

I. Mutual Fund Characteristics

A mutual fund is a legal entity that pools money from investors for the purpose of investing in a diversified portfolio of securities, such as stocks, bonds and other assets.[10] Each mutual fund contracts with an investment adviser, which provides day-to-day professional management for the fund's portfolio.

Mutual funds are attractive to many investors because mutual funds, in general, offer investors professional management and exposure to a diversified portfolio of securities at an affordable cost. In addition, mutual funds offer investors a liquid investment because mutual fund shares must be redeemed by the fund when the shareholder chooses.

Mutual fund shares are not traded on a stock exchange. Investors invest in a mutual fund by purchasing shares of the fund directly from the mutual fund. At the end of each day that a mutual fund is open for business, the values of the fund's assets (principally securities and cash) are totaled. From that total, the mutual fund's liabilities are subtracted (e.g., accrued fees payable to fund service providers) to arrive at the fund's net asset value ("NAV"). A mutual fund's *per-share* NAV—the purchase price to an investor—is simply the fund's NAV divided by the total number of fund shares that are issued and outstanding. The Investment Company Act of 1940 (hereinafter, "Investment Company Act")[11] requires that all share sales and redemptions by a mutual fund must occur at a price equal to the per-share NAV determined each business day after the mutual fund closes for business.[12]

Unlike mutual fund shares, the shares of a publicly owned operating company—e.g., Apple, Procter & Gamble, Citigroup or

10. A mutual fund is organized under state law. Of the 9,697 mutual funds existing as of December 31, 2011, approximately 41 percent were organized as Massachusetts business trusts; 33 percent were organized as Delaware statutory trusts, and 17 percent were organized as Maryland corporations. INVESTMENT COMPANY INSTITUTE, 2012 INVESTMENT COMPANY FACT BOOK 199 (2012). The remaining 9 percent were organized under the laws of other states. *Id.*

11. 15 U.S.C. §§ 80a-1–80a-64 (2011).

12. *See* 17 C.F.R. § 270.22c-1(a) (2011).

MetLife—are traded on a stock exchange. The price that an investor pays to purchase a share of an exchange-traded operating company is the current market value of the company's already issued shares, which typically varies throughout the trading hours of the stock exchange.

To offer new shares publicly and to satisfy redemption requests from existing shareholders, mutual funds engage in continuous offerings of their shares.[13] In contrast, publicly owned operating companies do not continuously offer or redeem their shares. Compared to mutual funds, day-to-day and year-to-year, publicly owned operating companies have a stable number of their equity shares issued and outstanding. Table 1 demonstrates these points by comparing the share sales activities of Apple Inc., a publicly owned operating company, and The Growth Fund of America ("GFA"), a very large and successful mutual fund.

Table 1

Apple Inc. and GFA: Common Stock Activity (FY2011)

	Apple[14]	**GFA**[15]
Market Capitalization	$375 billion	$137 billion
No. Shares Sold Publicly	0	830 million
No. Shares Redeemed	0	1.7 billion
Value Shares Sold Publicly	0	$25.1 billion
Value Shares Redeemed	0	$50.4 billion

Table 1 shows that, during its 2011 fiscal year, Apple Inc. sold zero shares publicly. In contrast, during its 2011 fiscal year, the value

13. To engage in a continuous offering of its shares, a mutual fund maintains an updated or "evergreen" prospectus with the Securities and Exchange Commission. *See* 17 C.F.R. § 270.8b-16(a) (2011).

14. Apple Inc., Annual Report (Form 10-K), (Oct. 26, 2011). Apple Inc. reported that, for the year ending September 24, 2011, the number of its shares of common stock increased, through private sales to employees, by approximately 13.3 million shares (1.5 percent) to total approximately 929 million shares issued and outstanding. In total, these 929 million shares were worth approximately $375 billion, based on Apple Inc.'s approximate $400 per-share price on September 24, 2011. *Id.*

15. The Growth Fund of America, Inc., Annual Report (Form N-CSR), (Oct. 31, 2011). The GFA's NAV as of August 31, 2011 was approximately $137 billion (approximately $29 per share). *Id.*

of shares sold publicly by the GFA was $25.1 billion, or the equivalent of 18 percent of the GFA's period-end NAV.

While the GFA's $25.1 billion in annual share sales is significant, for money market mutual funds, shares of which are usually held as short-term investments, the level of sales activity can be even greater.[16] For example, during their 2011 fiscal years, the value of shares sold publicly by the Vanguard Prime Money Market Fund was approximately $140 billion (about 120 percent of the fund's period-end NAV),[17] and the value of shares sold publicly by the Federated Government Obligations Fund was approximately $212 billion (about 700 percent of the fund's period-end NAV).[18]

Table 2, which presents the share sales activity of *all* U.S. mutual funds, shows that the share sales activities of the mutual funds described above are not unique.

Table 2

All Mutual Funds' Aggregate Share Sales and NAV[19]
(trillions)

	Share Sales (Gross)	Year-End NAV
2007	$23.5	$12.0
2008	$26.3	$9.6
2009	$20.7	$11.1
2010	$18.2	$11.8
2011	$17.8	$11.6

Table 2 shows that during each of the last five years, the aggregate value of shares sold by mutual funds was significant in

16. These heightened sales figures for money market mutual funds, in part, are due to the fact that such funds are used by institutional investors (*e.g.*, corporate treasurers, pension funds) for the short-term management of the cash needed to support their daily operations. *See* INVESTMENT COMPANY INSTITUTE, REPORT OF THE MONEY MARKET WORKING GROUP 28 (2009) ("As of January 2008, an estimated 80 percent of U.S. [non-financial] companies used money market funds to help them manage their cash balances, making these funds the most popular cash management vehicle.").

17. Vanguard Money Market Reserves (Prime Money Market Fund), Annual Report (Form N-CSR), (Nov. 2, 2011).

18. Money Market Obligations Trust (Government Obligations Fund), Annual Report (Form N-CSR), (Sept. 28, 2011).

19. INVESTMENT COMPANY INSTITUTE, *supra* note 10, at 134–35.

absolute terms (i.e., *trillions* of dollars) and greater than the funds' aggregate year-end NAV.

The following comparison also is helpful to appreciate the magnitude of mutual fund share sales activity. The 2011 year-end total value of all U.S. public companies' equities was $17 trillion.[20] However, in 2011, the total value of shares sold by mutual funds, $17.8 trillion, was greater.

II. NSMIA's Advent

State laws that regulate the sale of securities are often referred to as "blue sky laws."[21] In 1911, Kansas became the first state to enact its own blue sky laws[22] and, today, blue sky laws exist in every state and the District of Columbia.[23]

At the federal level, the 1929 stock market crash and the ensuing Great Depression led Congress to enact the Securities Act of 1933 (hereinafter, "Securities Act").[24] The Securities Act, like state blue sky laws, regulates the sale of securities by an issuer. Most notably, the Securities Act requires issuers offering their shares to the public, including mutual funds, to register the shares with the Securities and Exchange Commission ("SEC").[25] Thus, with the 1933 enactment of the Securities Act, an issuer's public sale of its securities within the United States became subject to the concurrent jurisdiction of the states and the federal government.[26]

20. *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., *Flow of Funds Accounts of the United States: Flows and Outstandings Fourth Quarter 2011*, at 94 Table L.213 (Mar. 8, 2012).

21. The term "blue sky law" entered the legal vernacular to describe legislation targeted at stock promoters who "would sell building lots in the blue sky in fee simple." LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, 1 SECURITIES REGULATION 53 (4th ed. 2006).

22. *Id*. at 50; *see also* Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws,* 70 TEX. L. REV. 347, 359 (1991).

23. LOSS, SELIGMAN & PAREDES, *supra* note 21, at 59.

24. 15 U.S.C. §§ 77a–77aa(2011).

25. *See* 15 U.S.C. § 77e (2011).

26. Congress recognized that the full disclosure requirements within the Securities Act and the antifraud provisions within the Securities Exchange Act of 1934 (hereinafter, "Exchange Act"), 15 U.S.C. §§ 78a–78pp (2011), were not sufficiently responsive to the particular problems of the investment company industry. Walter P. North, *A Brief History of Federal Investment Company Legislation,* 44 NOTRE DAME L. REV. 677 (1969). Ultimately, this recognition and a lengthy study by the SEC led to the enactment of the Investment Company Act. *See id*. at 678–79.

Nevertheless, for at least forty years after the Securities Act was enacted, any conflict between state blue sky laws and the Securities Act regarding mutual funds' share sales remained largely theoretical. In hindsight, this is not surprising. As seen in Figure 1, mutual fund share sales began to expand only in the late 1970s.

The late-1970s expansion in mutual fund share sales was due almost wholly to the expansion of money market mutual funds. From 1977 through 1982, money market mutual funds' total NAV increased from less than $4 billion to about $220 billion (representing, at year-end 1982, 74 percent of the total NAV of *all types* of mutual funds).[27] The surge in money market fund assets was driven by the period's high inflation rates, which averaged 10.1 percent annually between 1977 and 1981 (peaking in 1979 at 13.3 percent),[28] and the fact that, during this inflationary period, most bank savings accounts, which were the investment vehicle by which most Americans saved, were prohibited from paying more than approximately 5 percent annual interest.[29]

Money market mutual funds also introduced many investors to mutual funds generally and, therefore, were a factor in the subsequent growth of mutual funds of all types. From 1980 to 1996, the portion of U.S. households owning shares of mutual funds of all types increased from 5.7 percent to 32.7 percent.[30]

27. *See* INVESTMENT COMPANY INSTITUTE, *supra* note 10, at 136.

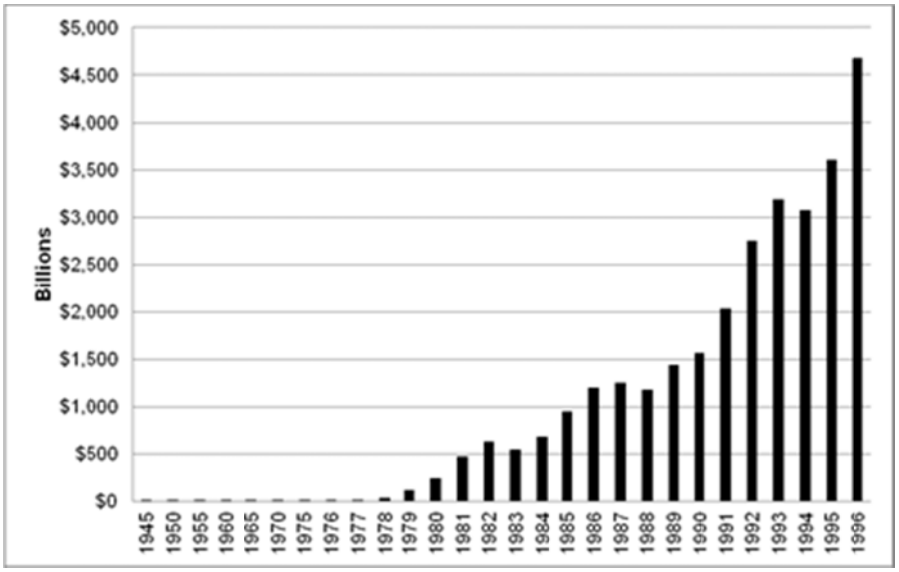
28. *See* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CONSUMER PRICE INDEX ALL URBAN CONSUMERS (CPI-U) (Malik Crawford *et al.*, eds., Mar. 16, 2012).

29. *See* R. Alton Gilbert, *Requiem for Regulation Q: What It Did and Why It Passed Away*, THE FED. RES. BANK OF ST. LOUIS REV. 22, 30–32 (Feb. 1986); MATTHEW P. FINK, THE RISE OF MUTUAL FUNDS: AN INSIDER'S VIEW 80 (2008).

30. *See* INVESTMENT COMPANY INSTITUTE, 17 ICI RESEARCH PERSPECTIVE NO. 5., 27–28 (Oct. 2011).

Figure 1

Mutual Fund Share Sales (1945-1996)[31]



The growth of mutual fund share sales, depicted in Figure 1, coincided with state efforts to regulate mutual funds. A well-placed industry insider has described the state battles, beginning in 1980 and usually instigated by local banking interests, to prohibit or limit money market mutual funds.[32] Thereafter:

> [t]he greatest change in mutual fund regulation during the record bull market of 1982-2000 took place with respect to regulation by the states. From the start of the first mutual fund in 1924, each state was free to regulate a fund offering shares in that state. Most of the time, state regulators were not active. They simply received filings to register fund shares for sale in the state and collected registration fees. Periodically, state regulation involved more than filings, fees, and administrative headaches . . . Once in a while, a particular state would impose a unique requirement. Because almost all

31. INVESTMENT COMPANY INSTITUTE, *supra* note 10, at 129.

32. *See* FINK, *supra* note 29, at 87-94. Mr. Fink was employed by the Investment Company Institute ("ICI"), a national association of mutual funds, from 1971 to 2004, serving as the ICI's president from 1991 to 2004.

> mutual funds as a practical matter are obliged to offer their shares in all fifty states, an idiosyncratic requirement imposed by a single state became, in effect, a nationwide requirement.
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> * * *
>
> [Beginning in the 1970s,] the [Investment Company Institute's] Blue Sky Guide . . . summarized each state's requirements and was updated on a regular basis. . . . In addition, by compiling all fifty states' requirements in one place, the guide demonstrated how awful the situation was.
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> * * *
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> Moreover, the situation was getting worse. In many cases, when the SEC simply announced that it was going to look at a particular area or there was a press story on some alleged problem, one or more states would start imposing its own requirements. For years, the [ICI] dealt with state problems on a case-by-case emergency basis. The number of problems accelerated when the fund industry took off in the early 1980s—funds became more visible, and the SEC and the media became more active, thus precipitating more actions by individual states.[33]

In 1995, SEC chairman Arthur Levitt delivered an important speech concerning the dual regulation of securities offerings by the states and the federal government, in which he stated:

> The fact that fund sales are national also makes a good case for national regulation. Some of the stories told about the current system sound like Kafka: What is a national [mutual fund] supposed to do when several states impose investment limitations that conflict with federal law—and conflict with one another?[34]

Ultimately, Congress responded. In enacting the National Securities Markets Improvement Act of 1996 ("NSMIA"), Congress recognized that participants in public securities distributions were "subject to a dual system of regulation that, in many instances, is

33. *See* FINK, *supra* note 29, at 196–98.

34. Arthur Levitt, "The SEC and the States: Toward a More Perfect Union," speech to the North American Securities Administrators Association, Vancouver, B.C. (Oct. 23, 1995) (transcript available at http://www.sec.gov/news/speech/speecharchive/1995/spch058.txt).

redundant, costly, and ineffective.[35] With respect to the distribution of mutual fund shares, the Senate Banking Committee Report stated:

> Currently, a mutual fund must register its shares with the SEC and comply with registration requirements in each of the fifty states where it wishes to publicly offer its securities. Although there is some similarity among state's [sic] registration requirements . . . the fifty states still require up to sixteen different approaches to regulation. For example, some states comment on the mutual fund prospectus and limit the types of investments certain funds may make . . . This "crazy quilt" of regulation has made registration of mutual fund shares unnecessarily cumbersome—in some cases leading mutual funds to restrict their fund offerings to residents of certain states.[36]

NSMIA effected several changes to the federal securities laws to promote efficiency and capital formation by eliminating overlapping federal and state securities regulations.[37] With respect to mutual funds, NSMIA resolved the problem of overlapping regulation by preempting state substantive regulation and registration requirements of mutual funds, thereby providing for exclusive federal jurisdiction over the contents of a mutual fund's prospectus and operation of each fund.[38] NSMIA preserved for the states the authority of "state securities regulators to continue to exercise their police power to prevent fraud."[39] Finally, NSMIA also preserved state authority to require mutual funds to file sales reports indicating the value of shares sold or to be sold to persons located within the state, and to require mutual funds to pay filing fees in connection with the sales reports.[40]

With respect to securities issued publicly by operating companies, NSMIA preempted state registration requirements.[41] In addition, states were prohibited from imposing issuer sales report requirements if the securities in question were to be traded on a

35. H.R. REP. NO. 104-864, at 39 (1996) (Conf. Rep.).
36. S. REP. NO. 104-293, at 6 (1996) (S. Comm. on Banking, Hous., & Urban Affairs).
37. *See* H.R. REP. NO. 104-864, at 39.
38. NSMIA § 102, (codified at 15 U.S.C. § 77r (2011)).
39. H.R. REP. NO. 104-864, at 40. *See* 15 U.S.C. § 77r(c)(1) (2011).
40. *See* 15 U.S.C. § 77r(c)(2) (2011).
41. *See* 15 U.S.C. § 77r(a)(1) (2011).

national securities exchange, such as the New York Stock Exchange or the NASDAQ Stock Market.[42]

III. Post-NSMIA: The States and Notice Filing Fees

Today, every state, with the exception of Florida, requires mutual funds to file a sales notice annually with the state's designated securities regulator. Among other things, the sales notice requires each mutual fund to report the value of its shares sold or to be sold to persons within the state.

Each state also requires a notice filing fee to be paid by each mutual fund in connection with the fund's sales notice. Typically, a notice filing in each state remains effective for one year and, on or before the expiration of the current notice, a mutual fund must file another sales notice and pay the appropriate notice filing fee.

Notice filing fees vary from state to state. Many states are "flat fee" states because their blue sky laws provide that a mutual fund's annual notice filing fee is the same, regardless of the number or value of the fund's in-state share sales. For example, Colorado, New Jersey, and Maine are flat fee states, and require a mutual fund to pay, respectively, notice filing fees of $325,[43] $500,[44] and $1,000.[45] There are approximately thirty flat fee states.

A second, similar category consists of "maximum fee" states in which the blue sky laws require a mutual fund, with its annual state sales notice, to pay a notice filing fee that is based on the value of the mutual fund's shares sold within the state, but subject to a maximum notice filing fee. For example, California requires a mutual fund to pay $200 plus one-fifth of one percent (0.20 percent) of the aggregate value of fund shares sold in California, with a maximum annual fee of $2,500.[46] Delaware is similar, except that its maximum annual fee is equal to one-half of one percent (0.50 percent) of the aggregate value of the mutual fund's shares sold in Delaware, with a maximum annual fee of $1,000.[47] Approximately fourteen states, as well as the District of Columbia, fall within this category.

42. *See* 15 U.S.C. § 77r(c)(2)(D) (2011).

43. COLO. DEP'T OF REGULATORY AGENCIES, DIV. OF SEC. FEE SCHEDULE, *available at* http://www.dora.state.co.us/securities/feeschedule.htm (last visited July 11, 2012).

44. N.J. ADMIN. CODE § 13:47A-7.9 (2011).

45. ME. REV. STAT. tit. 32, § 16302 (2011).

46. CAL. CORP. CODE. § 25608.1 (2011).

47. *See* 6 DEL. ADMIN. CODE § 403 (2011).

The third and final category of states, and the category that is the focus of this article, consists of Premium Fee States—Texas, Washington, Minnesota, Nebraska, and West Virginia—each of which requires a mutual fund, with its annual state sales notice, to pay a notice filing fee that is based on the value of the mutual fund's shares sold within the state, without any maximum or ceiling.

Technically, Wisconsin falls within the second category of maximum fee states because, for Wisconsin sales, a mutual fund's required notice filing fee is based on the value of the fund's shares sold within Wisconsin and is subject to a maximum annual fee. Prior to July 1, 2009, Wisconsin required a mutual fund to pay a fee equal to one-twentieth of one percent (0.05 percent) of the aggregate value of fund shares sold within Wisconsin, with a maximum annual fee of $1,500.[48] Effective July 1, 2009, the maximum annual fee, still calculated at the rate of one-twentieth of one percent, was increased tenfold to $15,000.[49] Thus, beginning in 2009 and continuing to the present, Wisconsin's maximum annual notice filing fee of $15,000, applied separately to each class of shares of a mutual fund, sets it apart from the remaining maximum fee states.[50] Because Wisconsin now requires mutual funds to pay annual notice filing fees that are both comparable to the fees required by the other five Premium Fee States and disproportionately greater than the notice filing fees paid by mutual funds to the remaining states, Wisconsin is also a Premium Fee State in this article.

Table 3 presents the manner in which each Premium Fee State calculates a mutual fund's annual notice filing fees.

48. *See* 2009 WIS. ACT 28 § 2999 (2009); WIS. LEGISLATIVE FISCAL BUREAU LFB 2009-11, JOINT COMM. ON FINANCE: MUTUAL FUND FEES, Paper346 (Apr. 16, 2009).

49. WIS. STAT. § 551.614 (2011).

50. *See* Table 4. Of the states within the maximum fee category, after Wisconsin, Arizona's maximum fee of $3,500, applicable to each class of shares of a mutual fund, is the next largest maximum fee. Pennsylvania requires mutual funds to pay $4,000 at the trust level, rather than the class-of-shares level. A single trust may have multiple mutual funds, and each fund may have multiple classes of shares. The 9,697 mutual funds existing as of December 31, 2011, offered a total of 22,366 classes of shares; *see* INVESTMENT COMPANY INSTITUTE, *supra* note 10, at 140, or an average of 2.3 classes per mutual fund. Therefore, all other things equal, mutual funds would pay more each year to a maximum fee state with a maximum fee applicable to each *class* of shares than the identical funds would pay to a maximum fee state with a maximum fee applicable at the *trust* level.

Table 3

Premium Fee States' Mutual Fund Notice Filing Fees

Texas	A fee equal to 1/10 of 1 percent (0.10%) of the aggregate value of fund's shares sold that year to persons in Texas, based on the shares' offering price.[51]
Washington	A fee equal to $100 for the first $100,000 of fund's shares sold that year to persons in Washington, plus an additional fee equal to 1/20 of 1 percent (0.05%) of the aggregate value of fund's shares in excess of $100,000 sold that year to persons in Washington, based on the shares' offering price.[52]
Minnesota	A fee equal to 1/20 of 1 percent (0.05%) of the aggregate value of fund's shares sold that year to persons in Minnesota, based on the shares' offering price.[53]
Nebraska	A fee equal to 1/10 of one percent (0.10%) for the first $10 million of fund's shares sold that year to persons in Nebraska, plus an additional fee equal to 1/20 of 1 percent (0.05%) of the aggregate value of fund's shares in excess of $10 million sold that year to persons in Nebraska, based on the shares' offering price.[54]

51. *See* TEX. REV. CIV. STAT. ANN. art. 581, §§ 7, 35 (West, 2011). Pursuant to statutory authority, the Texas Securities Board has promulgated a notice filing fee schedule for money market mutual funds that reduces the marginal fee rate as the fund's annual Texas sales surpass certain breakpoints. The annual notice filing fee rates by a money market mutual fund are, for the portion of the fund's Texas share sales in excess of: (i) $10 million, one-twentieth of one percent (0.05 percent), (ii) $20 million, one-fiftieth of one percent (0.02 percent); (iii) $50 million, one-hundredth of one percent (0.01 percent); and (iv) $100 million, one two-hundredth of one percent (0.005 percent). *See* 7 TEX. ADMIN. CODE § 123.3(d) (2011). The introduction to the relevant regulation states: "[B]ecause these funds continuously offer to repurchase their own securities and issue new securities to new and repeat investors, an excessive amount of fees may be paid under the Texas Securities Act, § 35.B(2), for the securities issued." *Id*. § 123.3(a).

52. *See* WASH. REV. CODE §§ 21.20.327, 21.20.340 (2011).

53. *See* MINN. STAT. §§ 80A.50, 80A.65 (2011).

54. *See* NEB. REV. STAT. §§ 8-1108.02-.03 (2012).

West Virginia	A fee equal to 1/20 of 1 percent (0.05%) of the aggregate value of fund's shares sold that year to persons in West Virginia, based on the shares' offering price.[55]
Wisconsin	A fee equal to 1/20 of one percent (0.05%) of the aggregate value of fund's shares sold that year to persons in Wisconsin, based on the shares' offering price, but subject to an annual maximum of $15,000 for each class of fund's shares.[56]

The fees paid by a single mutual fund to a Premium Fee State can be significant. For example, in 2010, the GFA paid approximately $293,000 to the Texas State Securities Board,[57] and approximately $46,000 to the Washington State Department of Financial Institutions.[58] The Federated Capital Reserves Fund, a large money market fund, paid approximately $2.5 million to the Texas State Securities Board in 2010 and approximately $375,000 to the Washington State Department of Financial Institutions in 2011.

Viewed from the industry level, the fees paid by all mutual funds to the Premium Fee States also are significant. Table 4 presents the total notice filing fees paid by all mutual funds to each of the Premium Fee States in fiscal years 2009, 2010 and 2011. Table 4 also indicates the portion of the total U.S. population that resides in the Premium Fee States.

55. *See* W. VA. SEC. COMM., STATEMENT OF POLICY (JULY 17, 2007), *available at* http://www.wvsao.gov/securitiescommission/Files/Registration/Administrative%20Regulation%20Section%209.pdf.

56. *See* WIS. STAT. § 551.614 (2011).

57. Notice fees paid by mutual funds are collected by the Texas State Securities Board. *See* TEX. REV. CIV. STAT. ANN. art. 581, § 35. (West, 2011). Data on notice fees collected by the Texas State Securities Board are provided online by the Board on its website: http://www.ssb.state.tx.us/public/SecuritiesSearch.php. All other things equal, smaller mutual funds would be expected to have fewer Texas share purchasers and, therefore, would pay smaller notice filing fees in Texas.

58. Notice fees paid by mutual funds are collected by the State of Washington Department of Financial Institutions. *See* WASH. REV. CODE § 21.20.327. (2011). Data on notice fees collected by the Washington State Department of Financial Institutions are derived from the statutory fee rate and each fund's reported sales, which are available online:https://fortress.wa.gov/dfi/licenselu/dfi/licenseLU/LicenseLLU.aspx. All other things equal, smaller mutual funds would be expected to have fewer Washington share purchasers and, therefore, would pay smaller notice filing fees in Washington.

Table 4

Mutual Funds' Total Notice Filing Fees Paid to Premium Fee States
(millions, except population)

	2011 U.S. Population[59]	FY2009	FY2010	FY2011
Texas[60]	8.2%	$85.1	$92.7	$107.7
Washington[61]	2.2%	$35.3	$26.2	$27.1
Minnesota[62]	1.7%	$30.4	$28.3	$30.6
Wisconsin[63]	1.8%	$8.7	$29.7	$30.4
Nebraska[64]	0.6%	$14.0	$12.9	$13.9
W. Virginia[65]	0.6%	$6.6	$6.3	$6.8
Total	15.1%	$180.1	$196.1	$216.5

59. U.S. CENSUS BUREAU, ANNUAL ESTIMATES OF THE RESIDENT POPULATION FOR THE UNITED STATES, REGIONS, STATES, AND PUERTO RICO: APRIL 1, 2010 TO JULY 1, 2011 (July 12, 2012), *available at* http://www.census.gov/popest/data/state/totals/2011/index.html.

60. E-mail from Kara L. Kennedy, Gen. Counsel, Tex. State Sec. Bd., to author (Jan. 13, 2012) (on file with author) (filing fees data).

61. E-mail from Faith Anderson, Chief of Registration & Gen. Counsel, Sec. Div. of the State of Wash. Dep't of Fin. Insts., to author (Jan. 5, 2012) (on file with author) (filing fees data).

62. E-mail from Robert Moilanen, Dir., Div. of Sec., Minn. Dep't of Commerce, to author (Apr. 11, 2012) (on file with author) (filing fees data).

63. E-mail from Patricia D. Struck, Adm'r, Div. of Sec., Wis. Dep't of Fin. Insts., to author (May 31, 2012) (on file with author) (filing fees data). Effective July 1, 2009, Wisconsin increased its notice filing fees significantly. *See supra* notes 48, 49, 50, and accompanying text.

64. E-mail from Jack E. Herstein, Assistant Dir., Bureau of Sec., Neb. Dep't of Banking and Fin., to author (Feb. 14, 2012) (on file with author) (filing fees data). According to Mr. Herstein, of the aggregate fee data provided to the author, which included mutual fund notice filing fees and other fees paid to the Bureau, "approximately 75% [of each year's fees] were for the payment of or by notice filings by mutual funds." *Id.* Therefore, the Nebraska fees presented in Table 4 are 75 percent of each year's aggregate fees reported to the author.

65. E-mail from Daniel Reed, Registration Examiner, Sec. Comm., W. Va. State Auditor, to author (Apr. 30, 2012) (on file with author) (filing fees data).

Collectively, the six Premium Fee States are home to approximately 15 percent of the U.S. population.[66] However, each year, approximately 50 percent of the total notice filing fees paid by mutual funds to all states is paid to the Premium Fee States. For the three fiscal years 2009, 2010 and, 2011, mutual funds paid the six Premium Fee States an annual average of approximately $200 million in notice filing fees. During the whole three-year period, mutual funds paid the Premium Fee States approximately $600 million in notice filing fees.

State notice filing fees, like any other mutual fund expense, are paid from a fund's assets. Therefore, the notice filing fees paid to the Premium Fee States during this three-year period represent a transfer of mutual fund shareholder wealth of approximately $600 million to the six Premium Fee States. If the $200 million annual total payments to the Premium Fee States continue, in present value dollars, these payments are equivalent to a one-time transfer of mutual fund shareholder wealth to the six Premium Fee States of between $2 billion and $4 billion.[67]

IV. The Constitutional Validity of the Fees Exacted from Mutual Funds by the Premium Fee States—As Regulatory Fees

If challenged, each Premium Fee State's notice filing fee could be categorized as a state "regulatory fee," which is a fee or other exaction intended to reimburse the state for costs incurred in regulating or policing a type of business or an activity. Alternatively, a notice filing fee exacted by a Premium Fee State could be categorized as a state tax, which is exacted to raise revenue for general state purposes. For the purposes of this article, this distinction is relevant because the Commerce Clause limitations on a state's power to impose a regulatory fee on interstate commerce differ from the due process and Commerce Clause limitations on a state's power to tax interstate commerce.[68]

66. *See supra* Table 4.

67. The present value of a perpetual annual payment of $200 million is $2 billion (assuming a 10 percent discount rate) or $4 billion (assuming a 5-percent discount rate). *See* RICHARD BREALEY & STEWART MEYERS, PRINCIPLES OF CORPORATE FINANCE 30–33 (2nd ed. 1984). The range of discount rates, 5 percent to 10 percent, is reasonable for this analysis based upon a comparison to the S&P 500's 10-year average annual return of 8.1 percent as of September 24, 2012, as well as the Vanguard Total Bond Market Index Fund's benchmark index's 10-year average annual return of 5.5 percent as of August 31, 2012.

68. *See* Am. Trucking Ass'ns v. Michigan Pub. Serv. Comm., 545 U.S. 429, 434 (2005); Freeman v. Hewit, 329 U.S. 249, 253 (1946); V-1 Oil Co. v. Utah State Dept. of

To reach a conclusion regarding the constitutional validity of the Premium Fee States' notice filing fees, the approach followed in this article is to examine the constitutional validity of these fees as regulatory fees (Part IV) and as state taxes (Part V).

A. Dormant Commerce Clause Restraints on Regulatory Fees

NSMIA preempted state regulations and registration requirements applicable to mutual funds but preserved the authority of "state securities regulators to continue to exercise their police power to prevent fraud."[69] Thus, it is appealing to categorize the Premium Fee States' current notice filing fees as regulatory fees, which are intended to recover the states' expenses to police mutual funds for fraud in the sales of their shares and to administer the collection of notice filing fees.[70]

The Commerce Clause empowers Congress to "regulate Commerce . . . among the several States . . .."[71] This provision does not expressly prohibit the states from regulating interstate commerce. However, the Supreme Court's longstanding interpretation is that, while the Constitution does not expressly limit state power to regulate interstate commerce, the Commerce Clause is an implicit restraint on state power, even when there is no conflicting federal statute.[72] This negative implication within the Commerce Clause is referred to as the "negative" or "dormant" Commerce Clause,[73] and provides the

Pub. Safety, 131 F.3d 1415, 1422 (10th Cir. 1997); Ferndale Labs., Inc. v. Cavendish, 79 F.3d 488, 494 (6th Cir. 1996); Aldens, Inc. v. LaFollette, 552 F.2d 745, 749–50 (7th Cir. 1977), Franks & Sons, Inc. v. Washington, 966 P.2d 1232, 1238 (Wash. 1998). *Accord* Walter Hellerstein, *Is "Internal Consistency" Dead?: Reflections on an Evolving Commerce Clause Restraint on State Taxation,* 61 TAX L. REV. 1, 23 (2007). *See also* Commonwealth Edison Co. v. Montana, 453 U.S. 609, 622 n.12 (1981)(citing Interstate Transit, Inc. v. Lindsey, 283 U.S. 183, 190 (1931)).

69. H.R. REP. NO. 104-864, at 39 (1996) (Conf. Rep.).

70. In fact, the relevant Senate Report stated:

> The legislation approved by the Committee provides for states to continue carrying out their important role of policing fraud in connection with investment company offerings. The states will also continue to collect registration or "appropriate" fees that may be used to augment existing antifraud programs.

See S. REP. NO. 104-293, at 6 (1996) (S. Comm. on Banking, Hous., & Urban Affairs).

71. U.S. CONST. art. I, § 8, cl. 3.

72. *See* United Haulers Ass'n., Inc. v. Oneida–Herkimer Solid Waste Mgmt. Auth., 550 U.S. 330, 338 (2007)(citing Cooley v. Bd. of Wardens, 53U.S. 299, 318–319 (1852)). The limitation arises in dictum in Gibbons v. Ogden, 22 U.S. 209 (1824).

73. *See* Mark L. Mosley, *The Path out of the Quagmire: A Better Standard for Assessing State and Local Taxes Under the Negative Commerce Clause*, 58 TAX LAW. 729

Supreme Court with the power to nullify state laws and regulations that impose an undue burden on interstate commerce.[74]

The Supreme Court has relied on the dormant Commerce Clause to strike down state regulations in order to "effectuate the Framers' purpose to 'preven[t] a State from retreating into economic isolation . . ..'"[75] According to the Court, application of the dormant Commerce Clause to limit state regulation of interstate commerce is justified by concerns of state "economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors."[76] Thus, the Court has struck down state laws and regulations that create commercial barriers or discriminate against an object of commerce based upon its place of origin or intended out-of-state destination.[77]

When a state's exercise of its regulatory power is challenged on dormant Commerce Clause grounds, the courts employ a two-tiered approach. The preliminary question is whether the challenged law discriminates against interstate commerce.[78] "Discriminates" simply means that the law results in disparate economic treatment between in-state interests and out-of-state interests.[79] Any discriminatory law is virtually per se invalid,[80] and will survive only if the state can demonstrate, under rigorous scrutiny,[81] that the law "advances a

n.3 (2004-2005); Julian N. Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 425n.1 (1982).

74. *See* City of Philadelphia v. New Jersey, 437 U.S. 617, 622-23 (1978).

75. *See* Fulton Corp. v. Faulkner, 516 U.S. 325, 330 (1996) (quoting Oklahoma Tax Comm. v. Jefferson Lines, Inc., 514 U.S. 175, 180 (1995)) (brackets omitted). *See also* S. Cent. Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 92 (1984) (stating that "[t]he Commerce Clause was designed 'to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.'") (quoting Hughes v. Oklahoma, 441 U.S. 322, 325 (1979)).

76. Dep't of Revenue v. Davis, 553 U.S. 328, 337–38 (quoting New Energy Co. v. Limbach, 486 U.S. 269, 273–274 (1988)).

77. *See*, *e.g., City of Philadelphia*, 437 U.S. at 626-27 (striking down New Jersey statute that barred out-of-state waste from its landfills); Hughes v. Oklahoma, 441 U.S. 322 (1979) (striking down Oklahoma law that prohibited the export of natural minnows).

78. *See United Haulers*, 550 U.S. 330, 338 (2007).

79. Oregon Waste Sys., Inc. v. Dept. of Envtl. Quality, 511 U.S. 93, 99 (1994).

80. *See United Haulers*, 550 U.S. at 338; *City of Philadelphia*, 437 U.S. at 624.

81. Maine v. Taylor, 477 U.S. 131, 138–144 (1986) (upholding Maine's ban on the import of baitfish because Maine lacked any alternative to prevent spread of parasites and harm to native fish species).

legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives."[82]

If the court finds that the challenged statute discriminates against interstate commerce, whether intentionally or in effect,[83] the burden shifts to the "State to justify it both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake."[84] By itself, "revenue generation is not a local interest that can justify discrimination against interstate commerce."[85]

The second tier of dormant Commerce Clause analysis is reached only if the challenged statue is found not to discriminate. Assuming a state law does not discriminate against interstate commerce, it nevertheless will be struck down if fails to pass the "undue burden" test enunciated by the Supreme Court in 1970 in *Pike v. Bruce Church, Inc.*:

> Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. . . . If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local

82. *Oregon Waste Sys.*, 511 U.S. at 101 (internal quotation marks omitted) (citing New Energy Co. v. Limbach, 486 U.S. 269, 278 (1988)); *Taylor*, 477 U.S. at 138.

83. *See* Chem. Waste Mgmt. v. Hunt, 504 U.S. 334, 344 n.6 (1992). If a state legislature has "disclose[d] an avowed purpose to discriminate" the law will be struck down. *See* Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1951). Otherwise, to determine whether a state law discriminates against interstate commerce, a court will examine the challenged law's "overall effect . . . on both local and interstate activity," without regard to the challenged statute's name, description, or the characterization given it by the legislature or the courts of the state to determine for itself the practical impact of the law. *See* Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573, 579 (1986); *Hughes*, 441 U.S. at 336. Moreover, a state legislature's non-discriminatory intent in enacting a statute is irrelevant to the analysis. *See City of Philadelphia*, 437 U.S. at 626–27.

84. Hunt v. Washington Apple Adver. Comm., 432 U.S. 333, 353 (1977); Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

85. C & A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383, 393 (1994).

> interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.[86]

A subset of the dormant Commerce Clause challenges to state regulations concern regulatory fees. These cases establish that, for a challenge to succeed, the claimant must persuade the court that the challenged fee is excessive for the declared regulatory purpose. The Supreme Court set forth the relevant test in 1984 in Commonwealth Edison Company v. Montana.[87] In its decision, the Supreme Court first noted that regulatory fees and charges are not "tested by standards which generally determine the validity of taxes."[88] Instead, the Court stated:

> Because such charges are purportedly assessed to reimburse the State for costs incurred in providing specific quantifiable services, we have required a showing, based on factual evidence in the record, that "the fees charged do not appear to be manifestly disproportionate to the services rendered. . . ." Clark v. Paul Gray, Inc., 306 U.S., at 599 [1939]; See *id*., at 598–600; Ingels v. Morf, 300 U.S., at 296–297 [1937].[89]

Both of the two cases cited in Commonwealth Edison—Paul Gray and Morf—involved challenges to California's imposition of regulatory fees under versions of a "caravanning" statute. The purpose of the statute was to regulate the transportation of automobiles, in multiple-vehicle caravans, into California for resale. Under the statute, caravanning was prohibited, unless each vehicle transported into California carried a special permit issued by the California State Motor Vehicle Department, for which a fee of fifteen dollars was exacted.[90]

86. *Bruce Church,* 397 U.S. at 142. In 2007, the Supreme Court reaffirmed that the *Bruce Church* balancing test continues to apply to nondiscriminatory state laws that are directed to legitimate local concerns. *See* United Haulers Ass'n., Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth., 550 U.S. 330, 346 (2007).

87. Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981).

88. *Id*. at 622 n.12 (quoting Interstate Transit, Inc. v. Lindsey, 283 U.S. 183, 190 (1931)).

89. *Commonwealth Edison*, 453 U.S. at 622 n.12 (internal references omitted).

90. *See* Clark v. Paul Gray, Inc., 306 U.S. 583, 585-586 (1939); Ingels v. Morf, 300 U.S. 290, 292 (1937).

In both cases, the Supreme Court followed the principle that, in order for a state to justify an exaction on interstate commerce, the amount demanded by the state must approximate a reimbursement for the expense of providing facilities, or for enforcing regulations of that commerce.[91]

In Morf, the earlier of the two decisions, the challenged statute stated that the fees were intended to reimburse the state treasury for the added expense of administering the caravanning statute and policing the caravanning traffic, and the Supreme Court noted that this negated any other inference regarding the purpose of the fifteen dollar fee.[92] The Court agreed with the district court's findings with respect to the total fees collected, which were up to three times greater than the expenses incurred by the state, stating:

> [T]he permit fee bears no reasonable relation to the total cost of regulation, to defray which it is collected. [The district court] rightly held that the licensing provisions of the statute impose an unconstitutional burden on interstate commerce.[93]

Two years later, in Paul Gray, the Supreme Court examined an amended version of the caravanning statute. The amended statute provided for a $7.50 fee to be collected for administration and enforcement of the caravanning statute, and an additional $7.50 fee for the use of California's highways.[94] The Court noted that the Paul Gray claimants had offered no proof that either of the two $7.50 fees were excessive, while the state offered evidence to show that the costs of administration and policing under the statute were greater than those reviewed previously by the Court in Morf.[95] When the corrected and unchallenged state expenditures to enforce the caravanning statute were included in the analysis, the $105,000 collected annually under the challenged statute approximated the state's $133,000 annual expenses, and the Court concluded:

> The state is not required to compute with mathematical precision the cost to it of the services necessitated by the

91. *See Paul Gray*, 306 U.S. at 599–600; *Morf*, 300 U.S. at 294.
92. *See Morf*, 300 U.S. at 295-96.
93. *Id*. at 297 (emphasis added).
94. *Paul Gray*, 306 U.S. at 598-99.
95. *See id.* at 599.

> caravan traffic. If the fees charged do not appear to be manifestly disproportionate to the services rendered, we cannot say from our own knowledge or experience that they are excessive.[96]

While articulated differently in Morf ("bears no reasonable relation to") and Paul Gray ("manifestly disproportionate to"), the comparison of regulatory fees exacted to the state's cost of providing regulatory services is the standard approved by the Supreme Court in Commonwealth Edison. Thus, in exercising its regulatory power, a state may impose a fee or other exaction on interstate commerce to reimburse the state for the expense of regulating that commerce,[97] provided that such regulatory fees are not manifestly disproportionate to the state's expenditures to effect the regulation.[98]

96. *Id.* (emphasis added).

97. *See, e.g.,* Interstate Towing Ass'n, Inc. v. City of Cincinnati, 6 F.3d 1154, 1164–65 (6th Cir. 1993); Ferndale Labs., Inc. v. Cavendish, 79 F.3d 488, 494 (6th Cir. 1996); Union Pacific R.R.Co. v. Pub. Utility Comm'n of Oregon, 899 F.2d 854, 857 (9th Cir. 1990)*; accord* Washington AGO 1953-55 NO. 182, 1953 WL 45048 (Wash. A.G.); Nebraska Op. Atty. Gen. No. 98002, 1998 WL 8515 (Neb. A.G.).

98. Some cases concerning a challenge to a state regulatory fee—a fee intended to reimburse the state for costs incurred in regulating or policing a type of business or an activity—have analyzed the validity of the regulatory fee under the dormant Commerce Clause as a "user" fee. *See, e.g.*, Cent. for Auto Safety, Inc. v. Athey, 37 F.3d 139 (4th Cir. 1994), *cert. denied,* 514 U.S. 1036 (1995); New Hampshire Motor Transport Ass'n v. Flynn, 751 F.2d 43, 50 (1st Cir. 1984). Arguably, the confusion arises from the breadth of the language in *Commonwealth Edison*, in which the Supreme Court held that a Montana exaction was a tax and, therefore, the Court "put to one side those cases in which the Court reviewed challenges to 'user' fees or 'taxes' that were designed and defended as a specific charge imposed by the State for the use of state-owned or state-provided transportation or other facilities and services." Commonwealth Edison Co. v. Montana, 453 U.S. 609, 621 (1981). The Court cited *Morf* and *Paul Gray* as examples and, in addition, cited its user-fee decision in Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, Inc., 405 U.S. 707 (1972). The disputed fee underlying *Morf* was a regulatory fee, while *Paul Gray* concerned both a regulatory fee and a user fee. *See supra* notes 90 through 96 and accompanying text. As a general matter, user fees are "charge[s] imposed by the State for the use of state-owned or state-provided transportation or other facilities and services." Oregon Waste Sys., Inc. v. Dep't of Envtl. Quality, 511 U.S. 93, 103 n.6 (1994) (quoting *Commonwealth Edison*, 453 U.S. at 621). *Evansville*, unlike *Morf* and *Paul Gray*, was clearly a user fee dispute because the fee in question was imposed on airlines' use of an airport to help defray the state's costs in constructing and maintaining an airport. *See Evansville,* 405 U.S. at 709. In *Commonwealth Edison,* the Supreme Court acknowledged that user fees partake of the nature of a rent charged by the state, based upon its proprietary interest in its public property. *See Commonwealth Edison*, 453 U.S. at 622 n.12. Under *Evansville*, the dormant Commerce Clause test of a state user fee's validity is whether the fee does not discriminate against interstate commerce, is based on a fair approximation of use of the facilities, is *not excessive in relation to the benefits*

Typically, courts apply the Commonwealth Edison "manifestly disproportionate" standard as part of the *Bruce Church* balancing analysis, which examines whether the "burden imposed" on interstate commerce by the challenged fee or exaction is "clearly excessive in relation to the putative local benefits."[99]

B. Dormant Commerce Clause Restraints on Regulatory Fees Applied to the Premium Fee States' Notice Filing Fees

Table 5 presents additional Premium Fee State data for the purpose of determining whether the notice filing fees paid to a Premium Fee State are manifestly disproportionate to the state's cost of policing sales of mutual funds shares and administering the receipts of notice filing fees.[100] For each Premium Fee State, Column (A) in Table 5 identifies the securities regulator that both receives payment of mutual funds' notice filing fees and is responsible for administering and enforcing the antifraud provisions of the Premium Fee State's blue sky laws. Column (B) presents the total amount paid in notice filing fees by mutual funds to each securities regulator during fiscal year 2010.[101]

conferred. *See Evansville*, 405 U.S. at 717–20 (1972); Nw. Airlines, Inc. v. County of Kent, 510 U.S. 355, 369 (1994); Bridgeport & Port Jefferson Steamboat Co. v. Bridgeport Port Auth., 567 F.3d 79, 86 (2d Cir. 2009), *cert. denied*. Because the Premium Fee States' notice filing fees are not paid for the use of state-owned or state-provided property, it is appropriate to categorize the notice filing fees as regulatory fees instead of user fees.

99. *See, e.g.*, V-1 Oil Co. v. Utah State Dep't of Pub. Safety, 131 F.3d 1415, 1426–27 (10th Cir. 1997); *Interstate Towing*, 6 F.3d at 1164; *Ferndale Labs.*, 79 F.3d at 494. However, one federal Circuit Court of Appeals appears to have treated the *Commonwealth Edison* standard as a separate test from the *Bruce Church* balancing analysis. *See* U.S.A. Recycling, Inc. v. Town of Babylon, 66 F.3d 1272, 1285 n.12, 1287–88 (2d Cir. 1995), *cert. denied,* U.S.A. Recycling, Inc. v. Town of Babylon, 517 U.S. 1135 (1996).

100. The notice filing fees exacted by each of the Premium Fee States do not differentiate between mutual funds that are domestically incorporated or have their principal place of business located domestically, and mutual funds that are incorporated or have their principal place of business outside of the state. In each Premium Fee State, the applicable notice filing fees are based on the value of a mutual fund's shares sold within the Premium Fee State. For any particular value of mutual fund shares sold in a Premium Fee State, a domestic mutual fund thus would pay the same notice filing fees in that Premium Fee State as an out-of-state mutual fund. Accordingly, the notice filing fees in the six Premium Fee States appear to be nondiscriminatory.

101. Column (B)'s data were presented in Table 4.

Table 5

Premium Fee States' Securities Regulators:
Fund Fees Received, Expenses and Decade's No. of Fund Antifraud Cases

Securities Regulator (A)	2010 MF Fees (millions) (B)	2010 Expenses (millions) (C)	Decade's No. Fraud Actions (D)	Simple Ratio B/C (E)
Tex. State Securities Bd.	$92.7	$6.3[i]	0[ii]	14.7
Wash. Div. of Securities, Dep't of Fin. Insts.	$26.2	$5.1[iii]	0[iv]	5.1
Minn. Div. of Securities, Dep't of Commerce	$28.3	$0.5[v]	0[vi]	57
Wis. Div. of Securities, Dep't of Fin. Insts.	$29.7	$3.1[vii]	0[viii]	9.6
Neb. Bur. of Securities, Dep't of Banking& Fin.	$12.9	$1.3[ix]	0[x]	9.9
W. Va. Securities Comm'n, State Auditor	6.3	2.5[xi]	0[xii]	2.5

Column (C) of Table 5 presents, for fiscal year 2010, the expenditures by each Premium Fee State's securities regulator for all purposes.[102]

102. That is, the expenditures presented in Column (C) are those of the securities regulator only, and do not include expenditures of the larger organization of which the

In each Premium Fee State, the securities regulator also is responsible for administering the state's blue sky laws, including administering the state registration of securities sales not preempted by NSMIA, regulating securities broker-dealers and regulating certain investment advisers that are not regulated by the SEC. Therefore, in Table 5, with the exception of Minnesota, the expenses incurred by a securities regulator to police mutual funds for fraud in the sales of their shares and to administer the receipts of notice filing fees is a portion of the expenditures presented in Column (C). Minnesota is excepted because the Division of Securities within the Minnesota Department of Commerce provided specific data regarding its expenditures related to mutual funds. Thus, with the exception of Minnesota, the expenses presented in Column (C) significantly overestimate each securities regulator's expenditures to police mutual funds for fraud and to administer the receipts of notice filing fees.

Table 5's Column (D) shows that there were no antifraud actions instigated or threatened against mutual funds by the Premium Fee States' securities regulatory authorities during the ten-year period ending December 2011.[103] Therefore, Column (D) supports the conclusion that, with the exception of Minnesota, each securities regulator's total expenditures presented in Column (C) substantially overestimates each authority's expenditures in connection with policing sales of mutual fund shares and administering the receipts of notice filing fees.

Column (E) simply presents the ratio that Column (B) (revenues) bears to Column (C) (expenses). Column (E) thus estimates the multiple (e.g., ×2.5, ×10, etc.) by which mutual funds' 2010 payments to each Premium Fee State's securities regulator exceeds the authority's 2010 expenditures for all purposes (except Minnesota, for which the presented expenditures relate to mutual funds). The securities regulator in each of the Premium Fee States, except Minnesota, received anywhere from approximately three to fifteen times more in notice filing fees from mutual funds than the

securities regulator may be a department or division. Texas is the only Premium Fee State in which the authority is a stand-alone entity.

103. The absence from Column (D) of antifraud actions instigated or threatened *against mutual funds* by the securities regulatory authorities suggests that, in the Premium Fee States, the costs incurred policing mutual funds for fraud in the sales of their shares were negligible. This suggests that, with respect to mutual funds, the expenses incurred by the securities regulatory authorities in each of the Premium Fee States arose from administering the notice filing regime fees, rather than combating such fraud.

regulator's total annual budget. In Minnesota, the securities regulator received at least fifty times more in notice filing fees from mutual funds than the regulator expended to administer the state's notice filing fee regime and to exercise its antifraud powers with respect to mutual funds, which it had no occasion to do.

From Column (E), it is obvious that, in fiscal 2010, the amount paid by mutual funds in notice filing fees to the securities regulator in each Premium Fee State was manifestly disproportionate to the state's cost of regulating mutual funds.[104] The same was true for fiscal years 2009 and 2011.[105]

In sum, when analyzed as regulatory fees, the notice filing fees paid to each Premium Fee State are manifestly disproportionate to each Premium Fee State's cost of policing sales of mutual fund shares and administering the receipts of notice filing fees. Thus, the notice filing fee regime in each Premium Fee State fails to satisfy the standard approved by the Supreme Court in Commonwealth Edison. From this conclusion, it follows that, under the *Bruce Church* balancing analysis, each Premium Fee State's notice filing fee regime imposes a burden on interstate commerce that is clearly excessive in relation to the putative local benefits. Following *Bruce Church*, the notice filing fees in the Premium Fee States violate the dormant Commerce Clause and, therefore, should be struck down.

V. The Constitutional Validity of the Fees Exacted from Mutual Funds by the Premium Fee States—As State Taxes

This Part examines whether the Premium Fee States' notice filing fees are constitutionally valid as permissible assertions of each Premium Fee State's authority to tax. Analyzed as state taxes, each Premium Fee State must have a sufficient nexus or connection with the mutual fund share sales activities that it seeks to tax to satisfy due process and dormant Commerce Clause limitations.[106] Separately,

104. In *Morf*, where the total fees collected were up to three times greater than the expenses incurred by the state, the Supreme Court agreed with the district court's findings that the state's regulatory fees imposed an unconstitutional burden on interstate commerce. *See* Ingels v. Morf, 300 U.S. 290, 297 (1937).

105. For fiscal years 2009 and 2011, Table 4 presents the total amount paid in notice filing fees by mutual funds to each securities regulator. The sources cited in Column (C) (for 2010 expenditures) have online analogs for fiscal years 2009 and 2011. Each securities regulator's expenditures did not vary materially year to year.

106. State blue sky laws, as exercises of the states' police powers, do not violate the Due Process Clause or the dormant Commerce Clause. *See* Hall v. Geiger-Jones Co., 242 U.S. 539 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917); Merrick v.

even if a Premium Fee State has a sufficient nexus to the mutual funds' sales activities, the Premium Fee State's notice filing fees must be fairly apportioned to be constitutionally valid.

A. Due Process and Dormant Commerce Clause Nexus Restraints on State Taxes

While Congress may regulate conduct without regard to state boundaries, the jurisdiction of each state legislature is limited to activities or conduct that occurs within its borders.[107] With respect to state tax legislation, the constitutional prohibition against state taxation of values arising from activities outside the state's borders is located within the Due Process Clause and the dormant Commerce Clause.[108]

The Supreme Court's state tax jurisprudence contains a nexus requirement. The Supreme Court has stated that the purpose of this nexus requirement is to prohibit extraterritorial taxation.[109] That is, when a state seeks to assert its tax authority beyond its borders, the tax could be struck down on due process and dormant Commerce

N.W. Halsey & Co., 242 U.S. 568 (1917). *See also* A.S. Goldmen & Co. v. New Jersey, 163 F.3d 780, 789 (3rd Cir. 1999) (New Jersey blue sky law was valid because it did not attempt to regulate commerce "wholly outside" of its borders, and the law regulated the in-state portion of an interstate transaction). *See generally* Robert N. Rapp, *Misapplication of the Federal Extraterritoriality Principle in Limiting the Scope of Civil Remedies for Fraud under State Blue Sky Laws*, 39 SEC. REG. L.J. 279, 287–300 (2011). These cases concern the interstate application of the antifraud provisions of state blue sky laws under the state's police powers, but do not address whether the Premium Fee States' notice filing fees are constitutionally valid assertions of the Premium Fee States' authority to tax.

107. *See* BMW of North America, Inc. v. Gore, 517 U.S. 559, 570–73 (1996) (citing Bonaparte v. Tax Court, 104 U.S. 592, 594 (1881)) ("No State can legislate except with reference to its own jurisdiction . . . Each State is independent of all the others in this particular"); 1 LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-8, at 1074 (3rd ed. 2000) ("[T]he Court has articulated virtually a per se rule of invalidity for extraterritorial state regulations—*i.e.*, laws which directly regulate out-of-state commerce, or laws whose operation is triggered by out-of-state events."). *See generally* Bradley W. Joondeph, *The Meaning of Fair Apportionment and the Prohibition on Extraterritorial State Taxation*, 71 FORDHAM L. REV. 149, 173–74 (2002).

108. *See* Allied-Signal v. Dir., Div. of Taxation, 504 U.S. 768, 777 (1992) ("The principle that a State may not tax value earned outside its borders rests on the fundamental requirement of both the Due Process and Commerce Clauses."); Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 164 (1983) ("Under both the Due Process and the Commerce Clauses of the Constitution, a state may not, when imposing an income-based tax, 'tax value earned outside its borders.'"); MeadWestvaco Corp. v. Illinois Dep't of Revenue, 553 U.S. 16, 19 (2008) ("Due Process and Commerce Clauses forbid the States to tax 'extraterritorial values.'").

109. *See Allied-Signal*, 504 U.S. at 777 (1992) (citing Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–45 (1954)).

Clause grounds, unless the state has a sufficient nexus or connection to the values it seeks to tax.

In *Mobil Oil Corp. v. Comm'r of Taxes*,[110] the Supreme Court discussed the modern due process nexus required for a state to tax income generated in interstate commerce. The Court held that, in order for a state tax to be valid under the Due Process Clause, there must be some minimal connection between the taxing state and the activity from which the income is derived, and a rational relationship between the income attributed to the taxing state and the interstate values of the enterprise.[111] The Court has since reiterated this due process test.[112]

The seminal case in modern dormant Commerce Clause challenges to state taxes is *Complete Auto Transit, Inc. v. Brady*.[113] Since its 1977 *Complete Auto* decision, the Supreme Court has relied upon *Complete Auto* in virtually every dormant Commerce Clause challenge to a state tax.[114] In Complete Auto, the Court abandoned longstanding formalistic rules and set forth the modern, four-prong test for evaluating a state tax's validity under the dormant Commerce Clause. Under that four-part test, a state tax will be sustained against a dormant Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state.[115]

If there is an insufficient nexus or connection between the taxing state and the activity that the state seeks to tax, the Supreme Court will void the state tax in question under either the Due Process

110. Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425 (1980).

111. *Id*. at 436–37.

112. *See* Hunt-Wesson, Inc. v. Franchise Tax Bd., 528 U.S. 458, 464 (2000); *Container Corp.*, 463 U.S. at 165–66; Exxon Corp. v. Dep't of Revenue, 447 U.S. 207, 219–20 (1980). *Accord* Hercules Inc. v. Comm'r of Revenue, 575 N.W.2d 111, 116 (Minn. 1998).

113. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

114. *See, e.g.*, Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175 (1995); Barclays Bank PLC v. Franchise Tax Bd., 512 U.S. 298 (1994); Quill Corp. v. North Dakota, 504 U.S. 298 (1992); Am. Trucking Ass'ns, Inc. v. Smith, 496 U.S. 167 (1990); Amerada Hess Corp. v. Dir., Div. of Taxation, New Jersey Dep't of Treasury, 490 U.S. 66 (1989); D.H. Holmes Co. Ltd. v. McNamara, 486 U.S. 24 (1988); Am. Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266 (1987); Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981).

115. *Complete Auto*, 430 U.S. at 279. *See also Jefferson Lines*, 514 U.S. at 183 (1995) (citing Goldberg v. Sweet, 488 U.S. 252 (1989) (tax on telephone calls); D.H. Holmes Co. v. McNamara, 486 U.S. 24 (1988) (use tax); *Container Corp.*, 463 U.S. at 159 (franchise tax); *Commonwealth Edison*, 453 U.S. at 609 (severance tax)).

Clause[116] or the dormant Commerce Clause.[117] Therefore, in analyzing the constitutional validity of the Premium Fee States' notice filing fees as taxes, a critical question is whether each Premium Fee State has a sufficient nexus or connection with mutual fund share sales to in-state persons and the funds' revenues from these sales.

B. Relevant Precedents

Each of the following Supreme Court decisions involved a due process or dormant Commerce Clause challenge to a state's attempt to tax an out-of-state seller's sales revenues arising from sales to in-state purchasers.

In *Connecticut General Life Insurance Company v. Johnson*,[118] Connecticut General had entered into contracts with California-licensed insurers, reinsuring the insurers against loss on insurance policies that the insurers had entered within California with California residents. However, the reinsurance contracts were entered into in Connecticut, premiums under the reinsurance contracts were paid to Connecticut General in Connecticut, and losses under the reinsurance contracts were to be paid from Connecticut.

The State of California sought to tax Connecticut General's receipt of the gross reinsurance premiums received. The Supreme Court held that the tax was unconstitutional as applied to Connecticut General's reinsurance business because the tax violated the Due Process Clause. In particular, the Court held that the tax could not be sustained because "All that [Connecticut General] did in effecting the reinsurance was done without the state [of California] . . .. The tax cannot be sustained either as laid on property, business done, or transactions carried on within the state . . .."[119]

116. *See, e.g.*, ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354 (1982); Standard Oil Co. v. Peck, 342 U.S. 382 (1959).

117. *See, e.g.*, Allied-Signal v. Dir., Div. of Taxation, 504 U.S. 768 (1992); McLeod v. J.E. Dilworth Co. 322 U.S. 327 (1944); Morgan v. Parham, 83 U.S. 471 (1872).

118. Conn. Gen. Life Ins. Co. v. Johnson, 303 U.S. 77 (1938). *Accord* State Bd. of Ins. v. Todd Shipyards Corp., 340 S.W.2d 339 (Tex. App. Ct. 1960), *aff'd,* 370 U.S. 451 (1962); Dow Chemical Co. v. Rylander, 38 S.W.3d 741, 745–47 (Tex. App. Ct.),*cert. denied,* 534 U.S. 996 (2001); Dravo Corp. v. City of Tacoma, 496 P.2d 504, 507 (Wash. 1972); City of Tacoma v. Fiberchem, Inc., 722 P.2d 1357, 1360–61 (Wash. App. Ct. 1986).

119. *Connecticut General*, 303 U.S. at 82. In Gerling Global Reinsurance Corp. of America v. Low, 296 F.3d 832, 843 n.8 (9th Cir. 2002), *rev'd on other grounds sub nom.* Am. Ins. Ass'n v. Garamendi, 539 U.S. 396 (2003), the court recognized the continued vitality of *Connecticut General.*

In 1954, in *Miller Brothers v. Maryland*,[120] the Supreme Court invalidated Maryland's attempt to impose a use tax collection duty on a Delaware merchant on all over-the-counter sales in its Delaware store to Maryland residents. The Court stated that due process requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."[121] The Supreme Court held that Maryland could not impose a use tax collection duty on the Delaware merchant because Maryland lacked a definite link and some minimum connection to the Delaware transactions.[122]

In 1965, in *American Oil Company v. Neill*,[123] the Supreme Court relied on a due process analysis to nullify an excise tax that the State of Idaho sought to impose on the revenues received by an Idaho-licensed gasoline dealer from sales that occurred in Utah. While the sales transactions all occurred outside of Idaho, the purchaser transported the gasoline from Utah into Idaho. The Court held that Idaho could not constitutionally tax the dealer's extraterritorial sales because the sales lacked a sufficient nexus to Idaho, and such sales were insufficiently related to the dealer's other activities within Idaho.[124]

In 1944, in *McLeod v. J.E. Dilworth Company*.,[125] the Supreme Court voided Arkansas's attempt to apply its sales tax to a Tennessee machinery distributor. Any sales to Arkansas purchasers were obtained by traveling salesmen and submitted to the distributor's Tennessee home office for approval. The purchaser received title and possession upon delivery by the distributor to a common carrier in Tennessee. Moreover, all payments were effected through the distributor's Tennessee office. Therefore, the Court held, Arkansas'

120. Miller Bros. v. Maryland, 347 U.S. 340 (1954). *Accord* Peoples Gas, Light & Coke Co. v. Harrison Cent. Appraisal Dist., 270 S.W.3d 208, 218 (Tex. App. Ct. 2008), *cert. denied sub. nom.* Harrison Cent. Appraisal Dist. v. Peoples Gas, Light & Coke Co., 131 S.Ct. 2097 (2011); Neb. Op. Atty. Gen. No. 95038, 1995 WL 297244 (Neb. A.G.).

121. *Miller Bros.*, 347 U.S. at 344–45. *Accord* Pfizer Inc. v. Lancaster County Bd. of Equalization, 616 N.W.2d 326, 339 (Neb. 2000).

122. *See Miller Bros.*, 347 U.S. at 345–46.

123. Am. Oil Co. v. Neill, 380 U.S. 451, 457–58 (1965). *Accord* Dravo Corp. v. City of Tacoma, 496 P.2d 504, 509 (Wash. 1972); City of Tacoma v. Fiberchem, Inc., 722 P.2d 1357, 1360–61 (Wash. App. Ct. 1986).

124. *See American Oil*, 380 U.S. at 458.

125. McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944). *Accord* Bullock v. Lone Star Gas Co., 567 S.W.2d 493, 497 (Tex. 1978), *cert. denied,* 439 U.S. 985 (1978); Dow Chemical Co. v. Rylander, 38 S.W.3d 741, 745–47 (Tex. App. Ct.), *cert. denied,* 534 U.S. 996 (2001).

attempt to tax the Tennessee sales would violate the dormant Commerce Clause because "[f]or Arkansas to impose a tax on such transactions would be to project its powers beyond its boundaries . . .."[126]

The Supreme Court's 1951 decision in *Norton Company v. Department of Revenue*[127] concerned a Massachusetts manufacturer that maintained a branch office and a warehouse in Illinois. The manufacturer effected sales in Illinois through two distinct channels: (1) the manufacturer made sales through its Illinois branch office and warehouse and (2) the manufacturer conducted a mail order business from its headquarters in Massachusetts, which shipped orders directly to Illinois customers. Illinois sought to apply its gross receipts tax to all Illinois sales by the manufacturer, including the mail order sales. However, the Court held that the mail order sales from Massachusetts were outside Illinois's taxing power and, therefore, the dormant Commerce Clause prohibited Illinois from taxing the mail order sales revenues.[128]

Finally, the Supreme Court's 1992 decision in *Allied-Signal v. Director Divison of Taxation*[129] is an example of the current doctrine concerning the simultaneous Due Process Clause and dormant Commerce Clause nexus requirements that prohibit a state from taxing revenue or income derived by a taxpayer's activities outside of the state's borders. In *Allied-Signal*, the Court rejected New Jersey's attempt to impose its business tax on a portion of the $211 million gain that Allied-Signal's predecessor, Bendix, realized on the out-of-state sale of its 20.6 percent stock interest in an unrelated corporation, ASARCO. Bendix was a Delaware corporation with its commercial domicile and corporate headquarters in Michigan. During the relevant period, Bendix's primary operations in New Jersey involved developing and manufacturing aerospace products.

The Supreme Court stated that its precedents permit a state to tax a nondomiciliary corporation on an apportioned sum of the

126. *McLeod*, 322 U.S. at 330.

127. Norton Co. v. Dep't of Revenue, 340 U.S. 534 (1951).

128. *See id.* at 537–39.

129. Allied-Signal v. Dir., Div. of Taxation, 504 U.S. 768 (1992). *Accord* Peoples Gas, Light & Coke Co. v. Harrison Cent. Appraisal Dist., 270 S.W.3d 208, 218 (Tex. App. Ct. 2008), *cert. denied sub nom.* Harrison Cent. Appraisal Dist. v. Peoples Gas, Light & Coke Co., 131 S.Ct. 2097 (2011); Flight Options, LLC v. State, Dep't of Revenue, 259 P.3d 234, 240 (Wash. 2011); Harris v. Comm'r of Revenue, 257 N.W.2d 568, 571 (Minn. 1977); Pfizer Inc. v. Lancaster County Bd. of Equalization, 616 N.W.2d 326, 339 (Neb. 2000); Am. Tel. & Telegraph Co. v. Wisconsin Dep't of Revenue, 422 N.W.2d 629, 633–34 (Wis. 1988).

corporation's multistate business, provided the business is "unitary" (i.e., part of the same business).[130] However, a state may not tax a nondomiciliary corporation's income derived from unrelated business activity that occurs outside of the state (i.e., "non-unitary").[131]

The Court further stated:

> The principle that a State may not tax value earned outside its borders rests on the fundamental requirement of both the Due Process and Commerce Clauses that there be some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax. The reason the Commerce Clause includes this limit is self-evident: In a Union of 50 States, to permit each State to tax activities outside its borders would have drastic consequences for the national economy, as businesses could be subjected to severe multiple taxation. But the Due Process Clause also underlies our decisions in this area. Although our modern due process jurisprudence rejects a rigid, formalistic definition of minimum connection, we have not abandoned the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax . . .. The present inquiry . . . focuses on the guidelines necessary to circumscribe the reach of the State's legitimate power to tax.[132]

The one-time gain earned by Bendix in selling its ASARCO shares was not part of unitary business carried on by Bendix in New Jersey. Therefore, New Jersey lacked a sufficient nexus or connection to the out-of-state sale to tax an apportioned part of the income from the sale.[133]

C. For Tax Purposes, Sales of Mutual Fund Shares Do Not Occur Within a Premium Fee State's Borders

Mutual funds engage in continuous offerings of their shares.[134] Among the key service providers employed by a mutual fund[135] is the

130. *Allied-Signal*, 504 U.S. at 772-73 (citing ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 317 (1982)).

131. *Id.* at 773 (citing Exxon Corp. v. Dep't of Revenue, 447 U.S. 207, 224 (1980)).

132. *Allied-Signal*, 504 U.S. at 777-78 (internal citations and punctuation omitted).

133. *See id*. at 784.

134. *See supra* notes 13 through 20 and accompanying text.

fund's transfer agent.[136] As described below, unless a mutual fund's transfer agent is located within a Premium Fee State's borders, there is no sale within the Premium Fee State that the state has authority to tax.

A mutual fund's transfer agent is responsible for accepting (or rejecting) customers' purchase orders for the fund's shares.[137] In this role, a mutual fund's transfer agent is responsible for assuring that a customer's purchase order complies with the mutual fund's rules, including any minimum initial investment required by the fund, as well as certain legal requirements. The most important legal requirement is Rule 22c-1(a) under the Investment Company Act,[138] which specifics that a mutual fund may sell its shares only at the per-share NAV "next computed . . . after receipt of . . . an order to purchase." Because mutual funds normally calculate their NAV at 4:00 p.m. Eastern time, on any given day, an investor wishing to purchase a mutual fund's shares that day must assure that its purchase order is received before 4:00 p.m. by the fund's transfer agent "in

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135. *See* Rule 38a-1 under the Investment Company Act, 17 C.F.R. § 270.38a-1 (2011), which requires every mutual fund to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund, including policies and procedures that provide for the oversight of compliance by each investment adviser, principal underwriter, administrator, and *transfer agent* of the fund.

136. A transfer agent, as defined in Exchange Act § 3(a)(25), 15 U.S.C. § 78c-(3)(a)(25) (2011), is:

> any person who engages on behalf of an issuer of securities . . . in (A) countersigning such securities upon issuance; (B) monitoring the issuance of such securities with a view to preventing unauthorized issuance, a function commonly performed by a person called a registrar; (C) registering the transfer of such securities; (D) exchanging or converting such securities; or (E) transferring record ownership of securities by bookkeeping entry without physical issuance of securities certificates.

Transfer agents are required to register with, and are regulated by, the SEC. *See* 15 U.S.C. § 78q-1(c) (2011); 17 C.F.R. § 240.17Ad-1 *et seq.* (2011).

137. The following discussion presents a simplified example of an individual customer purchasing fund shares without the participation of a financial intermediary, such as such as a broker, bank, fund supermarket, insurance company, investment adviser, or retirement plan record keeper. *See generally* ROBERT POZEN & THERESA HAMACHER, THE FUND INDUSTRY: HOW YOUR MONEY IS MANAGED 338–39 (2011). Nevertheless, the example is sufficient. Many customers rely on a financial intermediary to effect purchases of a mutual fund's shares, and the financial intermediary is in privity of contract with a fund's transfer agent to provide "sub-transfer agent" services in lieu of the mutual fund's transfer agent. However, the provision of sub-transfer agent services by the financial intermediary is no more likely to occur within a Premium Fee State than the fund transfer agent's provision of its services. *See generally* INVESTMENT COMPANY INSTITUTE, *Navigating Intermediary Relationships* (Sept. 2009).

138. 17 C.F.R. § 270.22c-1(a) (2011).

good order"[139]—that is, accompanied by certain required information and payment and, more generally, in compliance with the mutual fund's instructions contained in the fund's prospectus. Purchase orders received in good order before 4:00 p.m. receive the per-share NAV determined that same day. A purchase order that is received but is not in good order normally will be rejected by the transfer agent.

For a first-time customer purchasing shares from one or more funds within a family of mutual funds, the funds' transfer agent must create a new account.[140] To set up an account, the transfer agent is responsible for a reviewing account applications received from the investor to extract a variety of information. Under provisions of the Patriot Act,[141] a mutual fund's transfer agent must verify each customer's identity by collecting the customer's name, date of birth, and physical address.[142] For tax purposes, the transfer agent also must obtain the customer's taxpayer identification number, which, for individuals, is normally the individual's Social Security number. If the information required by the transfer agent to set up an account is not received, the transfer agent normally will reject the first-time customer's purchase order.

A mutual fund's transfer agent also is responsible for collecting customer payments to purchase the fund's shares and transmitting these proceeds to the mutual fund's custodian bank. The transfer agent will give effect to the purchase order by seeing that the appropriate number of a mutual fund's shares are credited to the shareholder's account. The transfer agent thus maintains the definitive record of fund shareholders and the number of shares owned by each shareholder, including each day's fund purchase (and redemption) orders. This information is transmitted by the transfer agent to the mutual fund and, therefore, the transfer agent provides the number of fund shares outstanding, which the mutual fund must have in order to determine that day's per-share NAV (i.e., the per-share purchase price).

139. *See, e.g.*, SEC Rel. Nos. 33-8861, IC-28064 (Nov. 21, 2007) (containing proposed "Hypothetical Summary Prospectus—Prepared By SEC Staff").

140. In part, this simplified example is based on a more-detailed description provided by POZEN & HAMACHER, *supra* note 137, at 338–39.

141. USA Patriot Act, Pub. L. No. 107-56, 115 Stat. 272 (2001), *amending*, *inter alia*, the Bank Secrecy Act, 31 U.S.C. § 5311 *et seq.* (2011).

142. *See* 31 C.F.R. § 1024.220 (2011).

In sum, a sale of shares by a mutual fund to an investor turns on the transfer agent's receipt of a purchase order and related payment, and the subsequent performance by the transfer agent of certain actions.[143] Therefore, unless a mutual fund's transfer agent is located within a Premium Fee State's borders, there is no sale within the Premium Fee State that the state has authority to tax.[144]

D. The Premium Fee States' Notice Filing Fees in Light of Due Process and Dormant Commerce Clause Nexus Restraints on State Taxes

To satisfy both due process and dormant Commerce Clause concerns, a state must have a sufficient nexus or connection with the value or activity it seeks to tax. With respect to mutual funds, the activity and value that each Premium Fee State seeks to tax are mutual fund share sales to in-state persons and the funds' revenues from these sales.

However, because the sales of mutual fund shares occur where the fund's transfer agent is located, which normally will be outside of the Premium Fee State, such nexus or connection is missing for each Premium Fee State with respect to a fund's sales of its shares, even if

143. A separate federal statute prohibits a state from imposing any tax on the transfer of a security if the only basis for such tax is the fact that the transfer agent is located within that state. *See* Exchange Act § 28(d), 15 U.S.C. § 78bb(d) (2011). This does not detract from the fact that mutual funds' sales of their shares do not occur within the Premium Fee States and, therefore, may not be taxed by the Premium Fee States. Each state retains authority to impose a stock transfer tax if the state has a sufficient nexus or connection to the sale, such as the sale occurring within the state. Exchange Act § 28(d) was added as part of the Federal Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975). The report of the Senate's Committee on Banking, Housing and Urban Affairs stated that Exchange Act § 28(d) was desirable because state transfer taxes might inhibit unreasonably the development of an efficient national clearing and depository system for securities. *See* S. Rep. No. 94-75, 54, 60 (1975), *reprinted in* 1975 U.S.C.C.A.N 179, 232, 238. However, the Committee report also explained that the statute was "designed to facilitate the development of a national system for handling securities transactions while at the same time preserving the state taxing powers over transactions with which the taxing state has a traditional jurisdictional basis for taxation." *Id*. There is no evidence that Congress, in enacting Exchange Act § 28(d), was aware of the differences between transfer agents that acted solely as a registrar with respect to an issuer's shares and transfer agents for mutual funds. In the case of a mutual fund, receipt and acceptance of a purchase order by the fund's transfer agent is a condition of sale. Moreover, as described in the main body of the text, a mutual fund's transfer agent performs multiple functions beyond those of a bare registrar, including collecting customer payments to purchase the fund's shares and transmitting these proceeds to the mutual fund's custodian bank.

144. *See, e.g.*, Allied-Signal v. Dir., Div. of Taxation, 504 U.S. 768 (1992), Am. Oil Co. v. Neill, 380 U.S. 451 (1965); Norton Co. v. Dep't of Revenue, 340 U.S. 534 (1951); McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944); Connecticut Gen. Life Ins. Co. v. Johnson, 303 U.S. 77 (1938).

a purchaser is located within the Premium Fee State. Under both the Due Process Clause and the Commerce Clause, each Premium Fee State lacks authority to tax these out-of-state sales. This conclusion follows from each of the out-of-state-sales cases described in Part V.B, above, in which the Supreme Court, under the Due Process Clause or dormant Commerce Clause, struck down a state tax that a state sought to apply to an out-of-state sale.[145]

E. Due Process Clause and Dormant Commerce Clause Fair Apportionment Requirements for State Taxes

In Complete Auto, the Supreme Court held that fair apportionment is another independent prong of the Complete Auto four-part test.[146] Fair apportionment also is required to satisfy due process concerns.[147] Even if a state has a sufficient nexus with a portion of the value or activity it seeks to tax, for both due process and Commerce Clause purposes, the state cannot tax the portion of the value or activity earned or occurring outside its borders.[148] Instead, a state's tax on a multistate business must be fairly

145. Interestingly, New York and Texas formerly imposed a stock transfer (stamp) tax upon the sale of shares of stock. Such transfer tax statutes pre-date the dematerialization of stock certificates. *See generally* Martin J. Aronstein, *The Decline and Fall of the Stock Certificate in America,* 1 J. OF COMP. CORP. LAW & SEC. REG. 273 (1978). The New York statute imposed a tax upon any seller with respect to "all sales, or agreements to sell, or memoranda of sales and all deliveries or transfers of shares." *See* O'Kane v. State, 172 Misc. 829, 843 (N.Y. Ct. Cl. 1939), *aff'd,* 283 N.Y. 439 (1940). This language is virtually identical to the language in the Texas statute, which was based upon the New York statute. *See* Tex. Op. Atty. Gen. No. 0-7059 (Mar. 13, 1946). Authorities in both New York (*see* People *ex rel.* Hatch v. Reardon, 184 N.Y. 431, 449 (1906), *aff'd,* 204 U.S. 152 (1907); In the Matter of the Petition of Blinder, Robinson & Co., Inc. (May 29, 1985), 1985 WL 25226 (N.Y. Dept. Tax. Fin.)) and Texas (*see* Tex. Op. Atty. Gen. No. 0-7059 (Mar. 13, 1946); Tex. Op. Atty. Gen. No. WW-700 (Sept. 14, 1959)), concluded that the stock transfer tax did not apply where a sale occurs outside of the taxing state. *See generally* Francis X. Mannix, *Stock Transfer Tax vs. Transfer Recording Tax: Taxation of Assignments and Deliveries of Stock Effected Outside of New York*, 13 TAX MAG. 398, 401 (1935). Texas, of course, is one of the Premium Fee States, and these authorities pre-date the modern due process and dormant Commerce Clause analyses. Presumably, today, a Texas court would reach the same conclusion with respect to sales of mutual fund shares that occur outside of Texas because Texas lacks a sufficient nexus or connection to those sales to satisfy due process and dormant Commerce Clause concerns.

146. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

147. *See* ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 317–18 (1982); Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 436–37 (1980).

148. *ASARCO*, 458 U.S. at 315. *See, e.g.,* Connecticut Gen. Life Ins. Co. v. Johnson, 303 U.S. at 77, 80–81 (1938). *See also* Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 164 (1983).

apportioned to reflect the value and activity conducted within its borders.[149]

The fair apportionment requirement serves two constitutional purposes. First, the requirement bars states from imposing redundant or duplicative taxes on a business simply due to the fact that the taxpayer conducts business on an interstate basis.[150] This assures that interstate commerce is not disadvantaged relative to intrastate commerce. Second, the fair apportionment requirement limits states taxing authority to that portion of value that is fairly attributable to economic activity within the state[151] and, therefore, prevents states from asserting their tax authority to extraterritorial activity and values.[152]

149. While the Premium Fee States' notice filing fees can be analyzed as state taxes, the fees are not state *sales* taxes. According to the leading treatise, a sales tax is:

> a levy imposed on the purchaser's use or consumption of the item sold, with the tax burden resting on the consumer. To make it more likely that the economic incidence of the tax is borne by the consumer, state sales taxes usually are separately stated, and most states prohibit vendors from advertising that they will absorb the tax. Further, the tax itself is excluded from the base of the tax. In addition, sales taxes are collected from the purchaser by the seller and are imposed on a transaction-by-transaction basis. These features effectuate the understanding that the sales tax is a discrete charge, apart from the price of an item, that is paid by the consumer and collected by the vendor.

Walter Hellerstein, STATE TAXATION ¶ 12.01 (2012 supp.). In contrast, a "business activity tax" is:

> a direct tax—such as a corporate income tax, franchise tax, gross receipts tax, or capital stock tax—imposed on the profits or income or gross receipts or capital stock value of a business taxpayer, however measured, and which is distinct from indirect taxes such as sales or use taxes, which are essentially in the nature of excise taxes on a transaction or on the use of property.

Report of the Task Force on Business Activity Taxes and Nexus of the ABA Section of Taxation State and Local Taxes Committee, 62 TAX LAWYER 935, 936 n.2 (2009). This distinction is important because, in Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175 (1995), the Supreme Court stated that sales taxes, unlike gross receipts taxes, do not require fair apportionment and, therefore, may be levied without offending the apportionment prong of *Complete Auto*. *See Jefferson Lines,* 514 U.S. at 184–86.

150. *See Jefferson Lines,* 514 U.S. at 184; Gen. Motors Corp. v. Tracy, 519 U.S. 278, 299 n.12 (1997). *See also* Walter Hellerstein, Michael J. McIntyre & Richard D. Pomp, *Commerce Clause Restraints on State Taxation After Jefferson Lines*, 51 TAX L. REV. 47, 109 (1995).

151. *See Jefferson Lines*, 514 U.S. at 185; Goldberg v. Sweet, 488 U.S. 252, 263 (1989); *Container Corp*., 463 U.S. at 169–70.

152. *See* Joondeph, *supra* note 107, at 150 (2002); Walter Hellerstein, *Is "Internal Consistency" Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation*, 87 MICH. L. REV. 138, 186 (1988).

To determine whether a state tax is fairly apportioned, the Supreme Court examines whether the apportionment formula is both "internally consistent" and "externally consistent."[153]

The internal consistency test generally furthers the first purpose of fair apportionment by asking whether the tax in question results in multiple taxation of interstate business. To be internally consistent, a state tax must be structured so that if every state were to impose an identical tax, there would be no burden on interstate commerce that intrastate commerce also would not bear.[154] Because each Premium Fee State limits its notice filing fees to sales made to purchasers within its boundaries, the Premium Fee States' notice filing fees pass the internal consistency test.[155]

The external consistency test generally furthers the second constitutional purpose of fair apportionment by preventing states from asserting their tax authority to extraterritorial activity and values. External consistency does not examine the consequences of multiple states enacting the same tax. Rather, external consistency examines the economic justification for a state's claim upon 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."[156] The "threat of real multiple taxation (though not by literally identical statutes) may indicate a State's impermissible overreaching."[157]

Therefore, as a separate prerequisite, the external consistency test asks whether a state seeks to tax "only that portion of the

153. *Jefferson Lines*, 514 U.S. at 185 (citing *Goldberg*, 488 U.S. at 261, *Container Corp*., 463 U.S. at 169).

154. *Jefferson Lines*, 514 U.S. at 185. Applying the internal consistency test, the Supreme Court has held that a tax that exposes a multistate taxpayer to the risk of multiple taxation is invalid under the dormant Commerce Clause. *See, e.g*., Am. Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266, 284 (1987); Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue, 483 U.S. 232, 247–48 (1987); Armco, Inc. v. Hardesty, 467 U.S. 638, 644 (1984).

155. The notice filing fees of each Premium Fee State would apply equally to every mutual fund, regardless of whether the fund is located within or outside the state. Each state's notice filing fees apply only with respect to sales made to purchasers within the Premium Fee State. Thus, hypothetical equivalent fees by every other state (with respect to sales made to internal purchasers) would not result in multiple taxation because the hypothetical fees would not apply in the case of sales made to purchasers within the Premium Fee States.

156. *Jefferson Lines*, 514 U.S. at 185. *See Goldberg*, 488 U.S. at 262; *Container Corp.*, 463 U.S. at 169–70.

157. *Jefferson Lines*, 514 U.S. at 185.

revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed."[158] An unapportioned state tax on revenues or receipts from activities occurring outside the state will be struck down.[159] This includes the imposition of a tax by a Premium Fee State on mutual funds' revenues resulting from sales of shares because other states, such as the state in which the transfer agent is located, as well as the state in which the fund has its business situs,[160] are entitled to tax an apportioned part of the sales revenue.

The Premium Fee States' notice filing fees make no provision for the apportionment of the value of mutual funds' sales of shares and, therefore, violate the fair apportionment requirement under the Due Process Clause and the dormant Commerce Clause. As unapportioned taxes on mutual funds' revenues arising from activities that occur outside their borders, the Premium Fee States' notice filing fees should be struck down.

158. *Goldberg*, 488 U.S. at 262 (citing *Container Corp.*, 463 U.S. at 169-70). The Due Process Clause and dormant Commerce Clause require a sufficient nexus or connection between a state and the interstate value and activity it seeks to tax. *See supra* notes 109 through 117 and accompanying text. Separately, the external consistency component of fair apportionment limits a state's tax jurisdiction to assure that a state taxes only its fair share of an interstate transaction. The intersection between these two requirements has not gone unnoticed by commentators. *See* TRIBE, *supra* note 107, at 1140 n.42 (noting external consistency operates like a stronger version of the substantial nexus requirement); *Joondeph*, *supra* note 107, at 154 (observing that a state tax that is unfairly apportioned is likely to extend to interstate values or activities with which the state does not have a substantial nexus); Jeffrey A. Friedman & Kendall L. Houghton, *The Other Nexus: Transactional Nexus and the Commerce Clause*, 4 ST. & LOC. TAX LAW. 19, 26–30 (1999). Nevertheless, the Supreme Court has "consistently treated 'external consistency' . . . as a freestanding prerequisite." TRIBE, *supra* note 107, at 1136.

159. *See, e.g.*, Gwin, White & Prince v. Henneford, 305 U.S. 434, 438-39 (1939); Evco v. Jones, 409 U.S. 91, 93 (1972); Cent. Greyhound Lines v. Mealey, 334 U.S. 653, 662–63 (1948); *Jefferson Lines*, 514 U.S. at 186 ("Finally, in *Central Greyhound,* we held that New York's taxation of an interstate bus line's gross receipts was constitutionally limited to that portion reflecting miles traveled within the taxing jurisdiction."). *See also* Hellerstein, *supra* note 149, at ¶ 8.02[3A] (citing Tyler Pipe Indus., Inc. v. Dep't of Revenue, 483 U.S. 232 (1987); Standard Pressed Steel Co. v. Dep't of Revenue, 419 U.S. 560 (1975); Gen. Motors Corp. v. Dep't of Revenue, 377 U.S. 436 (1964)). *Accord* Nat'l Liberty Life Ins. Co. v. State, 215 N.W.2d 26, 37 (Wis. 1974). Sales of mutual fund shares are not localized, unless the fund and its transfer agent are located within the taxing state. Moreover, the Court's recognition in *Jefferson Lines* that a gross receipts tax was "simply a variety of tax on income, which was required to be apportioned to reflect the location of the various interstate activities by which it was earned" *Jefferson Lines*, 514 U.S. at 190, casts doubt on the validity of unapportioned taxes on gross receipts. *See* TRIBE, *supra* note 107, at 1139 n.37 (citing Hellerstein, McIntyre & Pomp, *supra* note150, at 97).

160. Traditionally, the state of a corporation's business situs has been able to assert jurisdiction over the corporation's income, wherever earned. *See* Joondeph, *supra* note 107, at 155 n.31; Hellerstein, *supra* note 149, at ¶ ¶ 8.02[1][a][i], 8.02[3A].

VI. Summary of Conclusions: The Premium Fee States' Exactions Are Constitutionally Invalid Regulatory Fees and State Taxes

Part IV and Part V of this article examined the constitutionality of the Premium Fee States' notice filing fees, which can be categorized either as state regulatory fees or as state taxes.

Part IV examined the notice filing fees in the Premium Fee States as regulatory fees. The analysis showed that the notice filing fees paid to each Premium Fee State were manifestly disproportionate to each Premium Fee State's cost to police mutual funds for fraud in the sales of their shares and to administer the receipts of notice filing fees. Thus, the notice filing fee regime in each Premium Fee State fails to satisfy the standard approved by the Supreme Court in Commonwealth Edison. Therefore, under the *Bruce Church* balancing analysis, each Premium Fee State's notice filing fee regime imposes a burden on interstate commerce that is clearly excessive in relation to the putative local benefits. Viewed as regulatory fees, under *Bruce Church*, the notice filing fees in each Premium Fee State violate the dormant Commerce Clause and should be struck down.

Part V examined the notice filing fees in the Premium Fee States as state taxes. To satisfy both due process concerns and dormant Commerce Clause concerns, a state must have a sufficient nexus or connection with the value or activity it seeks to tax. Part V showed that each Premium Fee State lacked this nexus or connection with respect to the sales of mutual fund shares, even when a share purchaser is located within the Premium Fee State. Thus, analyzed as a tax, the notice filing fees exacted by each Premium Fee State violate both the Due Process Clause and the dormant Commerce Clause and should be abrogated.

Part V also examined the notice filing fees in the Premium Fee States as state taxes for fair apportionment purposes. Each Premium Fee State's notice filing fee regime is unapportioned and, as a result, reaches the value of mutual funds' sales revenue attributable to activity outside of the state's borders. Because the Premium Fee States' notice filing fees are not fairly apportioned, the fees should be invalidated on due process and dormant Commerce Clause grounds. Thus, a fair apportionment analysis provides a separate basis for concluding that the Premium Fee States' notice filing fees, if viewed as taxes, are constitutionally invalid.

VII. Remedies

This Part examines a variety of issues that mutual funds' advisers and boards of trustees or directors (Board) may want to consider in developing strategies to recover notice filing fees previously exacted unconstitutionally by the Premium Fee States, and to persuade the Premium Fee States to reduce their notice filing fees to adhere to constitutional requirements.

A. The Financial Stakes

The Premium Fee States' notice filing fees exceed the amount that can be lawfully exacted from mutual funds as regulatory fees by approximately $200 million each year.[161] This figure represents a very rough estimate of the amount that mutual funds, in aggregate, would save in expenses if the Premium Fee States immediately brought their notice filing fees exacted from mutual funds into line with their actual expenditures to police mutual funds for fraud in the sales of their shares and to administer the receipts of notice filing fees.[162]

Wholly apart from prospective benefits to mutual funds and their investors, as compensation for prior years' unconstitutionally exacted notice filing fees, mutual funds may be able to recover the dollar amount of these fees paid in each Premium Fee State to the state's securities regulator.[163] Assuming a three-year statute of limitations, a ballpark estimate of the aggregate amount that could be recovered is $600 million, although statutory interest or a longer statute of limitations is likely to increase this estimate. However, no single state is liable for the total amount unconstitutionally exacted and, therefore, no single lawsuit would result in the recovery of the

161. The estimate of $200 million is derived from Table 4. For the 2010 and 2011 fiscal years shown in Table 4, mutual funds' payments to the Premium Fee States averaged more than $200 million annually. Fiscal 2009 is excluded because, in Wisconsin, effective July 1, 2009, the maximum annual notice filing fee was increased dramatically, s*ee supra* notes 48 through 50 and accompanying text, resulting in substantially greater notice filing fees for Wisconsin in 2010 and 2011 compared to 2009. *See* Table 4.

162. Thus, each year, mutual fund investors stand to benefit prospectively by approximately $200 million because an expense reduction would be reflected in each mutual fund's NAV and per-share NAV.

163. For example, 42 U.S.C. § 1983 (2011) provides in pertinent part:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State . . . subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress . . ..

aggregate amount. There are, after all, six Premium Fee States, although, as indicated in Table 5, Texas has the largest potential exposure, and Washington, Minnesota, and Wisconsin are roughly in a three-way tie for second with respect to the size of their potential exposures.

B. Cost-Benefit and Collective Action Issues

Virtually every mutual fund would benefit if each Premium Fee State were convinced to reduce its notice filing fees to adhere to constitutional requirements. However, the costs associated with convincing any single Premium Fee State, which may include the expenses of a lawsuit and related appeals, may be significant. The costs to any single family of mutual funds may exceed the expected benefits, in the form of lower notice filing fees and recovery of prior notice filing fees paid, that are likely to be received by the family of mutual funds. Thus, it is uncertain whether any single family of mutual funds would undertake the task of attempting to persuade a Premium Fee State to reduce its notice filing fees to adhere to constitutional requirements.

This cost-benefit problem is exacerbated by the fact that should a single family of mutual funds succeed in persuading a Premium Fee State to reduce its notice filing fees to adhere to constitutional requirements, that success would benefit all competing mutual fund families. The fee reduction would become a public good. Thus, each family of mutual funds has an incentive to do nothing while a competitor bears the costs of persuading a Premium Fee State. Thereafter, every mutual fund family would enjoy the same benefits as the competitor that incurred the costs of persuasion, but without paying for those benefits. This situation is simply a collective action problem (also known as a free rider problem).[164]

The cost-benefit uncertainty and the collective action problem could be overcome by employing a single representative for all mutual funds, with the costs underwritten by all mutual funds that stand to benefit from the representative's actions.

164. *See generally* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 1–2 (1965); Dan M. Kahan, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71 (2003).

C. The Minnesota Lawsuit

In fact, the national association of U.S. mutual funds, the Investment Company Institute ("ICI"), already has served as a representative plaintiff for all mutual funds with respect to pre-NSMIA state registration fees. Circa 1990, the ICI brought suit in a Minnesota state district court seeking to have the court strike down Minnesota's 1973 registration fee statute. The ICI appealed the district court's adverse decision to the Court of Appeals of Minnesota, which reported its 1991 decision in *Investment Company Institute v. Hatch*.[165]

In *Hatch*, the Minnesota appeals court addressed due process and equal protection arguments raised by the ICI. Relying on Minnesota due process precedents, the court acknowledged that "fees which are grossly disproportionate" to the costs of administering a regulatory program may constitute a "tax in disguise," which would be an invalid exercise of state police powers.[166] However, the court found that the statute's history and other evidence presented were insufficient to dissuade the court from its conclusion that the statute "was passed for both regulatory and revenue purposes" and, therefore, did not violate the Due Process Clause.[167]

While *Hatch* concluded that the Minnesota statute, in part, was a tax for due process purposes, the Minnesota appeals court did not examine the statute under due process and dormant Commerce Clause precedents concerning state taxes. This examination would have entailed analyses of whether (i) Minnesota had a sufficient nexus or connection with out-of-state sales of mutual fund shares, and (ii) Minnesota's registration fees were fairly apportioned such that the fees did not tax the value of mutual funds' sales attributable to activities outside of Minnesota. If the *Hatch* court had conducted these analyses, it would have had to conclude that the Minnesota statute could not have been passed validly for "revenue purposes" because, as a tax, Minnesota's fees violated the Due Process Clause and dormant Commerce Clause and, therefore, should be voided.

165. Investment Company Institute v. Hatch, 477 N.W.2d 747 (Minn. Ct. App. 1991).

166. *Hatch*, 477 N.W.2d at 749. This standard is consistent with the U.S. Supreme Court's "manifestly disproportionate" standard. *See supra* notes 87 through 98 and accompanying text.

167. *Hatch*, 477 N.W.2d at 752. The equal protection claim was disposed of by the court because the equal protection clause bars classifications "only when it is without any reasonable basis and therefore is purely arbitrary." *Id.* at 752–53.

Therefore, today, if a Premium Fee State asserted that its notice filing fees are taxes, Hatch would not be applicable precedent to analyze the due process and dormant Commerce Clause issues raised in this article concerning nexus to out-of-state sales and fair apportionment, because Hatch never reached these issues.

D. The Federal Tax Injunction Act

1. State Court or Federal Court

If a family of mutual funds or representative claimants contemplate instigating a lawsuit against one or more of the Premium Fee States, the federal Tax Injunction Act ("TIA") may affect whether the suit can be adjudicated in a federal court. The TIA provides: "[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."[168]

The "principal purpose of the TIA [is] to limit drastically federal court interference with the collection of state taxes,"[169] in recognition of the imperative need of a state to administer its collection of revenue.[170] The Tax Injunction Act divests the federal courts of jurisdiction, thereby requiring that constitutional challenges to a state tax must be brought in the courts of the taxing state. Decisions of the highest court of the taxing state may be reviewed by the Supreme Court by writ of certiorari.[171] On this forum issue, one commenter has asserted:

> These [state] courts are often unsympathetic to the tax claims of nonresidents . . . [and] the only review of state court decisions in these tax cases is by writ of certiorari to the U.S. Supreme Court . . . In this legal environment, state courts can choose to play what can be called "the cert lottery," holding

168. 28 U.S.C. § 1341 (2011). While the TIA refers only to suits to "enjoin, suspend or restrain" state tax administration, the TIA has been interpreted broadly to bar claims for declaratory and injunctive relief, *see* California v. Grace Brethren Church, 457 U.S. 393, 407–11 (1982); Great Lakes Dredge & Dock Co. v. Huffman, 319 U.S. 293 (1943), and to bar claims for refunds or monetary relief, *see* Nat'l Private Truck Council, Inc. v. Oklahoma Tax Comm'n, 515 U.S. 582, 588 (1995); Cumberland Farms, Inc. v. Tax Assessor, 116 F.3d 943, 945 (1st Cir. 1997).

169. Hibbs v. Winn, 542 U.S. 88, 105 (2004) (internal formatting omitted).

170. *See id*. (citing *Grace Brethren Church*, 457 U.S. at 409–10).

171. *See* 28 U.S.C. § 1257 (2011).

> for the home team while betting on the unlikelihood that aggrieved taxpayers can get the U.S. Supreme Court to hear their cases. The state courts will often win this gamble . . ..[172]

Because the TIA applies to state taxes and does not apply to state regulatory fees, user fees or other non-tax state exactions, litigation under the TIA frequently focuses on whether a state's exaction is a tax.[173] This determination is a question of federal law, and how a state has characterized an exaction does not control the outcome.[174] Instead, whether a state exaction is a "tax under State law" for purposes of the TIA will be determined in accord with Congress' purposes in enacting the TIA.[175]

The leading case in determining whether a state imposition is a tax is the First Circuit's 1992 decision in *San Juan Cellular Telephone Company v. Public Service Commission*,[176], written by Judge (as he then was) Breyer. In *San Juan Cellular*, the court stated:

> Courts have had to distinguish "taxes" from regulatory "fees" in a variety of statutory contexts. Yet, in doing so, they have analyzed the legal issues in similar ways. They have sketched a spectrum with a paradigmatic tax at one end and a paradigmatic fee at the other. The classic "tax" is imposed by a legislature upon many, or all, citizens. It raises money, contributed to a general fund, and spent for the benefit of the entire community. The classic "regulatory fee" is imposed by an agency upon those subject to its regulation. It may serve regulatory purposes directly by, for example, deliberately discouraging particular conduct by making it more expensive. Or, it may serve such purposes indirectly by, for example, raising money placed in a special fund to help defray the agency's regulation-related expenses.

172. Edward A. Zelinsky, *Rethinking Tax Nexus and Apportionment: Voice, Exit and the Dormant Commerce Clause*, 28 VA. TAX. REV. 1, 63 (2008) (internal footnote and formatting omitted).

173. *See* Hexom v. Oregon Dep't of Transp., 177 F.3d 1134, 1135 (9th Cir. 1999).

174. Wright v. McClain, 835 F.2d 143, 144 (6th Cir. 1987).

175. *See id.*; Robinson Protective Alarm Co. v. City of Philadelphia, 581 F.2d 371, 374 (3rd Cir.1978); Bidart Bros. v. California Apple Comm'n, 73 F.3d 925, 929–30 (9th Cir. 1996).

176. San Juan Cellular Tel. Co. v. Pub. Serv. Comm'n, 967 F.2d 683 (1st Cir. 1992).

> Courts facing cases that lie near the middle of this spectrum have tended (sometimes with minor differences reflecting the different statutes at issue) to emphasize the revenue's ultimate use, asking whether it provides a general benefit to the public, of a sort often financed by a general tax, or whether it provides more narrow benefits to regulated companies or defrays the agency's costs of regulation.[177]

In *Hager v. City of West Peoria*,[178] another leading case in determining whether a state imposition is a tax under the TIA, the Seventh Circuit expanded *San Juan Cellular*'s "ultimate use" test from the limited question of whether the imposition's revenues are destined for a state's general fund, to include an analysis of the purpose of the imposition:

> The district court in this case seized on the fact that the permit fee revenue was earmarked for the general city fund, and reasoned that under the "ultimate use" test, the permit fees were a tax. We believe the district court misconstrued this fact. Rather than a question solely of where the money goes, the issue is why the money is taken.[179]

177. *San Juan Cellular*, 967 F.2d at 685 (emphasis added). Other circuits have followed *San Juan Cellular*. *See* Travelers Ins. Co. v. Cuomo, 14 F.3d 708, 713 (2d Cir. 1993); Collins Holding Corp. v. Jasper County, 123 F.3d 797, 800 (4th Cir.1997); Home Builders Ass'n of Mississippi, Inc. v. City of Madison, 143 F.3d 1006, 1011 (5th Cir. 1998); Hedgepeth v. Tennessee, 215 F.3d 608, 612 (6th Cir. 2000); Hager v. City of West Peoria, 84 F.3d 865, 870–72 (7th Cir.1996); *Hexom*, 177 F.3d at 1136; Marcus v. Kansas Dep't of Revenue, 170 F.3d 1305, 1311 (10th Cir. 1999). In *San Juan Cellular*, and in subsequent decisions of the Circuit Courts that rely on *San Juan Cellular*, a variety of factors have been cited as probative regarding whether a particular state exaction is a tax or a regulatory fee: (i) whether the exaction was imposed by a state legislature rather than by an administrative agency; *see, e.g.*, Cumberland Farms, Inc. v. Tax Assessor, 116 F.3d 943, 946 (1st Cir. 1997); *Bidart Bros*., 73 F.3d at 931; *San Juan Cellular*, 967 F.2d at 685; (ii) whether responsibility for administering and collecting an exaction belongs to a state's general tax assessor or lies with a regulatory agency; *see, e.g.*, *Collins*, 123 F.3d at 800 (citing *Cumberland Farms,* 116 F.3d at 946); *Bidart Bros.,* 73 F.3d at 931; (iii) whether the revenues raised by the exaction go into a general fund or are deposited in a special fund to benefit regulated entities or defray the cost of regulation; *see, e.g.*, *Cumberland Farms*, 116 F.3d at 946 (citing *Travelers Insurance,* 14 F.3d at 713); *San Juan Cellular,* 967 F.2d at 685; *Collins*, 123 F.3d at 800, (citing *San Juan Cellular*, 967 F.2d at 685); and (iv) whether the underlying legislation refers to the exaction as a fee or a tax; *see, e.g.*, *Hager,* 84 F.3d at 871.

178. *Hager*, 84 F.3d 865.

179. *Id*. at 870–71 (emphasis in original).

In *Hager*, the Seventh Circuit reached the conclusion that a city's exaction was a regulatory fee to regulate the weight of trucks using city streets and, therefore, not a tax. The court relied on the stated purpose of the city's exaction in the text of the city ordinance, admissions by the city's mayor about the intended use of the revenues, and the fact that the relevant state enabling statute authorized the city "to regulate a vehicle carrying loads within the municipality."[180] The court noted that, while the funds received from the permit fee in question were deposited in the city's general fund, because the fee reasonably estimated the cost imposed by the person required to pay, the fee was better viewed as a regulatory fee than a tax.[181]

The Fifth Circuit, Ninth Circuit, and Tenth Circuit each have endorsed the Seventh Circuit's purpose-driven "why the money is taken" *Hager* inquiry to determine whether an exaction is a fee or a tax for purposes of the TIA.[182] The Fourth Circuit has indicated that, in cases that lie near the middle of the *San Juan Cellular* spectrum, the purpose of the statute or regulation containing the imposition is paramount,[183] and the Sixth Circuit has stated that "the inquiry on 'why the money is taken' instead of 'where the money goes'" is appropriate.[184]

Finally, the Eighth Circuit also seems amenable to treating, for TIA purposes, the legislative purpose underlying an exaction as

180. *Id.* at 871.

181. *Id*. at 871–72.

182. *See Home Builders*, 143 F.3d 1006, 1011–12 (5th Cir. 1998) ("[I]t must be noted that we are far more concerned with the purposes underlying the ordinance than with the actual expenditure of the funds collected under it. That is, we look principally to the language of the ordinance and the circumstances surrounding its passage."); *Hexom*, 177 F.3d at 1138 (9th Cir. 1999) ("The question, in the long run, is not simply where the money is deposited at some point; it is what the purpose or use of the assessment truly is. . . [E]ven monies paid into the general fund of the treasury are not necessarily taxes."); U.S. Chamber of Commerce v. Edmondson, 594 F.3d 742, 761–62 (10th Cir. 2010) ("[T]he touchstone of our inquiry is the purpose of the assessment . . . In judging purpose, we consider, among other things, the ultimate use of the funds . . . But use is not always conclusive evidence of purpose. Just as the label given by a state for an assessment or charge is not dispositive of its character . . . neither is the ultimate use of funds dispositive of an assessment's purpose . . . Thus, rather than a question solely of *where* the money goes, the issue is *why* the money is taken.") (emphasis in original).

183. *See* Valero Terrestrial Corp. v. Caffrey, 205 F.3d 130, 134 (4th Cir. 2000) ("When the [*San Juan Cellular*] three-part inquiry yields a result that places the charge somewhere in the middle of the *San Juan Cellular* descriptions, the most important factor becomes the purpose behind the statute, or regulation, which imposes the charge.").

184. Hedgepeth v. Tennessee, 215 F.3d 608, 614 n.6 (6th Cir. 2000).

determinative. In *Ben Oehrleins and Sons and Daughter, Inc. v. Hennepin County*,[185] the Eighth Circuit addressed the validity of a county ordinance that required county waste to be delivered to the county's designated facility, at which the waste haulers were required to pay the county's specified "tipping fees." The Eight Circuit noted that, for TIA purposes, the ordinance "obviously raises revenue by way of the tipping fees charged by the [waste] facility."[186] Without further analysis, the court held that this "does not, however, render the Ordinance a tax. The Ordinance's primary purpose is clearly regulatory, rather than revenue-raising."[187]

2. The State Legislature's Intent

If a Premium Fee State's mutual fund notice filing fees were challenged in a federal court on constitutional grounds, to retain jurisdiction to hear the lawsuit, following *San Juan Cellular* and *Hager*, the federal court is likely to inquire where the fees go, as well as why the state legislature imposed the fees. To retain jurisdiction, the federal court is likely to have to determine that: (i) when enacted or reenacted,[188] such fees were intended by the state legislature to be regulatory fees; and (ii) the state legislature did not subsequently revisit the notice filing fee statute to reclassify the fees as a tax.

If the federal court instead determines that the challenged notice filing fees were intended to be a tax, the TIA would deprive the federal court from exercising jurisdiction, and the plaintiffs would be required to bring their claims in a state court. Therefore, before commencing an action in a federal court, plaintiffs seeking to challenge a Premium Fee State's notice filing fees should review the legislative history of the relevant Premium Fee State's blue sky statute to determine whether, when the provisions applicable to

185. Ben Oehrleins & Sons & Daughter, Inc. v. Hennepin County, 115 F.3d 1372 (8th Cir. 1997).

186. *Id.* at 1382.

187. *Id.* at 1382–83. *Accord* Marigold Foods, Inc. v. Redalen, 834 F.Supp. 1163, 1166 (D.Minn. 1993) ("To determine whether the Minnesota premium is a tax, the court must look to the purpose underlying the premium.").

188. For example, in 2002, the National Conference of Commissioners on Uniform State Laws restated the Uniform Securities Act (2002 Uniform Act), which may have resulted in a Premium Fee State's restatement of its blue sky laws to conform to the 2002 Uniform Act. *See, e.g.*, Minn. Laws 196 – H.F. No. 2514, *available at* https://www.revisor.mn.gov/laws/?id=196&year=2006&type=0.

mutual fund fees were enacted,[189] the revenues were anticipated to estimate the cost of regulating mutual funds. If the legislative history suggests that, when enacted, a regulatory fee was contemplated or if the history is ambiguous, the review also should include an analysis of whether the state legislature ever revisited the underlying statute for the express purpose of reclassifying the fees as a tax.

Chronologically, mutual fund sales began to expand rapidly only in the late 1970s,[190] which resulted in significantly greater (pre-NSMIA) registration revenues to the Premium Fee States. In 1996, NSMIA provided that, unless subsequently changed by a state, the fees in effect prior to NSMIA's enactment would continue in effect, but as notice filing fees.[191] Therefore, it is possible that the Premium Fee States' legislatures have never revisited their blue sky fee statute, which provided for fees originally intended to be regulatory fees, for the express purpose of reclassifying the regulatory fees as taxes. This would be a helpful set of facts under *Hager*, which expanded the inquiry to include why the money is taken.

E. Issues for Advisers and Boards

This article has asserted that the costs to any single family of mutual funds may exceed the expected benefits—in the form of lower notice filing fees and recovery of notice filing fees already paid—that are likely to be received by the family of mutual funds. Whether this assertion is accurate, of course, is a question for each adviser to a family of mutual funds to consider. Notice filing fees are expenses incurred by mutual funds. The costs to persuade a Premium Fee State to reduce its notice filing fees to adhere to constitutional requirements and to seek compensation for notice filing fees unconstitutionally exacted also would be fund expenses. Therefore, a family of mutual funds' Board normally would be involved in deciding what actions the family of funds pursue.

If an adviser and Board conclude that the costs of available strategies outweigh the expected benefits to the family of mutual funds, the funds' adviser may decide to coordinate action with other

189. At present, the National Conference of Commissioners on Uniform State Laws' website indicates that, of the six Premium Fee States, only Minnesota and Wisconsin have adopted the 2002 Uniform Act. *See* The National Conference of Commissioners on Uniform State Laws, *available at* http://www.uniformlaws.org/Act.aspx?title=Securities Act.

190. *See supra* notes 27 through 29 and accompanying text, and Figure 1.

191. *See* 15 U.S.C. § 77r(c)(2) (2011).

families of mutual funds to develop strategies to persuade the Premium Fee States and to seek compensation for notice filing fees unconstitutionally exacted.

If other forms of persuasion fail, it is possible that litigation may be required to persuade the Premium Fee States to adhere to constitutional requirements. The number of law firms with experience in representing mutual funds and fund advisers in civil litigation is limited. Moreover, of those law firms, only a subset may have the litigation expertise and experience required to pursue successfully claims based on the Premium Fee States' violations of mutual funds' rights under the Due Process Clause and dormant Commerce Clause. Such expertise and experience is reflected in the fees of these qualified law firms. In short, litigation is likely to be expensive, and a favorable outcome is unlikely to be reached quickly.

However, assuming a representative plaintiff, makes itself available, the expense of pursuing litigation would appear to be justified. During the last three years, the six Premium Fee States have exacted approximately $600 million unconstitutionally.[192] Eliminating the annual $200 million unconstitutional exaction would be equivalent, in present value dollars, to a one-time savings by mutual funds of between $2 billion and $4 billion.[193] Therefore, a very rough estimate of the total value to mutual funds of success in obtaining compensation from the Premium Fee States for notice filing fees already unconstitutionally exacted ($600 million), and in persuading the Premium Fee States to reduce their notice filing fees to adhere to constitutional requirements ($2 billion to $4 billion), is $2.6 billion to $4.6 billion.

Conclusion

Regardless of whether the Premium Fee States' notice filing fees are deemed to be state regulatory fees or state taxes, these fees are constitutionally invalid and should be struck down.

In present value dollars, the potential benefits to mutual funds, consisting of reimbursement for notice filing fees already exacted from the Premium Fee States and future costs avoided, may be $2.6 billion to $4.6 billion.

There are six Premium Fee States. Vindicating mutual funds constitutional rights may require six separate lawsuits, and the TIA

192. *See supra* notes 66 and 67 and accompanying text.

193. *Id*.

could prevent claimants from having a federal court decide their claims in any of these lawsuits if the applicable state legislature intended that its notice filing fee statute should impose a tax. Therefore, research into the legislative history of the notice filing fee statute in each Premium Fee State is desirable before instigating a lawsuit.

ENDNOTES TO TABLE 5

i. State Sec. Bd., Operating Budget Fiscal Year 2012 Submitted to the Governor's Office of Budget, Planning and Policy and the Legislative Budget Board (revised Feb. 2, 2012) *available at* http://www.ssb.state.tx.us/About_Us/Agy%20312%20Oper%20Bdgt%20FY12%20revised.PDF (includes FY2010 expenditures).

ii. E-mail from Kara L. Kennedy, Gen. Counsel, Tex. State Sec. Bd., to author (Jan. 13, 2012) (on file with author).

iii. *See* Wash. State Fiscal Info., Expenditure History: Operating & Capital Dep't of Fin. Insts., 2009-2011, *available at* http://www.fiscal.wa.gov/FRViewer.aspx?Rpt=Recast History Expenditure Agency Detail. The value represents one half of: $8.1 million in expenditures directly attributed to the Division of Securities plus 23.8 percent (or $2.1 million) of "Administration" expenditures. The $2.1 million of Administration expenses is an estimate based on the percentage (23.8 percent) of the DFI's total non-Administration expenditures ($34.1 million) attributable to the Division's direct expenditures ($8.1 million), multiplied by the DFI's total Administration expenditures ($8.7 million)—i.e., [(8.1 ÷ 34.1) × 8.7 = 2.1]. The combined figure of $10.2 million was divided in half because the reported expenditures cover the two fiscal years, ending FY2011.

iv. In 2007, the Division of Securities of the Washington Department of Financial Institutions issued a Consent Order involving the *distributor* of the Oppenheimer mutual funds and pursuant to which the distributor agreed to pay approximately $400,000 in restitution to the Oppenheimer funds and $275,000 to the State of Washington, which consisted of a $100,000 fine and $175,000 to reimburse expenses incurred by the Division during the course of its investigation. *See* Oppenheimer Funds Distributor, Inc., Consent Order S-04-012-07-CO01 (Wash. Dept. Fin. Insts. Feb. 27, 2007), *available at* http://www.dfi.wa.gov/sd/orders/S-04-012-07-CO01.pdf. In the Order's agreed-upon facts section, the distributor acknowledged that it had assisted third parties to market time certain Oppenheimer mutual funds, and this assistance was not disclosed in the Funds' prospectuses. *See id*. at 3.

v. E-mail from Robert Moilanen, Dir., Div. of Sec., Minn. Dep't of Commerce, to author (April 16, 2012) (on file with author). *See also* Minn. Mgmt. & Budget, Departmental Earnings 2012-13 Biennial Budget, at 29, *available at* http://www.mmb.state.mn.us/doc/budget/report-earnings/12/commerce.pdf.

vi. These settlement orders are made available by the Minnesota Department of Commerce at two websites, depending on the date of the order. List of Enforcement Actions in Minnesota, *available at* http://www.state.mn.us/mn/externalDocs/Commerce/Securities_Enforcement_Actions_021411123936_SecuritiesActions.htm (2000-2006) (settlement orders from 2000 to 2006); *available at* https://www.cards.commerce.state.mn.us/CARDS/security/search.do?method=showSearchParameters&searchType=new (settlement orders from 2007-present). In 2012, the Minnesota Department of Commerce issued a Consent Order joining Minnesota to a previously negotiated settlement among five states (Alabama, Kentucky, Mississippi, South Carolina, and Tennessee) involving the distributor and the investment adviser of certain Morgan Keegan mutual funds. *See* Morgan Asset Management, Inc., File No. 21679 (Minn. Dep't Commerce) (Mar. 19, 2012), *available at* https://www.cards.commerce.state.mn.us/CARDS/security/search.do?method=showPoup&documentId={8F8CAF3E-E53D-46B8-9700-D9196626E13B}&documentTitle=81619&documentType=1; Regions Fin. Corp., Current Report (Form 8-K) (June 22, 2011).

vii. E-mail from Patricia D. Struck, Adm'r, Div. of Sec., Wis. Dep't of Fin. Insts., to author (July 3, 2012) (on file with author) (2010 budget).

viii. On May 20, 2004, the Division of Securities within the Wisconsin Department of Financial Institutions petitioned the Department to revoke the investment adviser and securities agent licenses of various persons associated with Strong Capital Management, Inc. and its subsidiaries. *See* Petition for Order, *available at* http://www.wdfi.org/_resources/indexed/site/newsroom/admin_orders/2004/ma_strong_pet.pdf. The licensees were involved, in one way or another, with market timing of the Strong family of mutual funds. The Strong funds were not parties to the action. On May 21, 2004, a subset of the parties to the petition agreed to a consent order from the Department in which their securities agent licenses were revoked. *See* Order of Revocation, *available at* http://www.wdfi.org/_resources/indexed/site/newsroom/admin_orders/2004/ma_strong_ord.pdf. The Order of Revocation adopted the remedial undertakings to which the Strong persons and entities had agreed in a May 20, 2004, SEC consent order, In the Matter of Strong Capital Management, Inc. et al., SEC Rel. No. IC-26448 (May 20, 2004).

ix. Neb. Dep't of Banking and Fin., 2011-2013 Biennial Budget Request, at 101-106 (Sept. 15, 2010), *available at* https://das-nebs.ne.gov/public/faces/brdIndex.jsp (includes FY2010 Bureau of Securities' expenditures).

x. E-mail from Sheila Cahill, Legal Counsel, Bureau of Sec., Neb. Dep't of Banking and Fin., to author (Feb. 15, 2012) (on file with author).

xi. W. Va. Executive Budget Fiscal Year 2012: Volume II Operating Detail, at 158, *available at* http://www.budget.wv.gov/executivebudget/archives/Documents/VIIOD2012.pdf (includes 2010 expenditures).

xii. *See* E-mail from Daniel Reed, Registration Examiner, Sec. Comm., W. Va. State Auditor, to author (May 9, 2012) (on file with author). The Securities Commission did instigate administrative actions against the advisers and distributors of certain mutual funds caught up in the market-timing scandals. *Id*.