IN THE SUPREME COURT OF THE STATE OF MISSISSIPPI
COURT OF APPEALS

ST. PAUL FIRE AND MARINE INSURANCE COMPANY; TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA; FIDELITY AND GUARANTY INSURANCE COMPANY; AND THE UNITED STATES FIDELITY AND GUARANTYCOMPANY — APPELLANTS

v. — CAUSE NO. 2009-CA-01248

ED MORGAN, CHAIRMAN, MISSISSIPPI STATE TAX COMMISSION

CONSOLIDATED WITH

FIDELITY & GUARANTY INSURANCE COMPANY — APPELLANT

v. — CAUSE NO. 2008-CA-1931

JOSEPH L. BLOUNT, IN HIS OFFICIAL CAPACITY AS COMMISSIONER OF THE MISSISSIPPI STATE TAX COMMISSION — APPELLEE

ON APPEAL FROM THE CHANCERY COURT OF HINDS COUNTY, MISSISSIPPI

BRIEF OF APPELLANT

ORAL ARGUMENT REQUESTED

SUBMITTED BY:

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JOSEPH L. BLOUNT, IN HIS OFFICIAL CAPACITY AS COMMISSIONER OF THE MISSISSIPPI STATE TAX COMMISSION **APPELLEE**

ON APPEAL FROM THE CIRCUIT COURT OF WARREN COUNTY, MISSISSIPPI

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons have an interest in the outcome of this case. These representations are made in order that the justices of the Supreme Court and/or judges of the Court of Appeals may evaluate possible disqualification or recusal.

1. St. Paul Fire and Marine Insurance Company, Appellant;
2. Travelers Casualty and Surety Company of America, Appellant;
3. Fidelity and Guaranty Insurance Company, Appellant;

4. The United States Fidelity and Guaranty Company, Appellant;

5. Mark D. Herbert, Attorney for Appellant;

6. Lisa A. Reppeto, Attorney for Appellant;

7. Ed Morgan, in his official capacity as Commissioner of the Mississippi State Tax Commission, Appellee;

8. Jim Powell, Attorney for the Appellee;

9. Jim Hood, Attorney General for the State of Mississippi;

10. Honorable Patricia Wise, Trial Court Judge;

11. Honorable William Hale Singletary, Trial Court Judge.

So certified this, the 25th day of February, 2010.

By: Lisa A. Reppeto
Lisa A. Reppeto

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STATEMENT OF THE CASE

The actions at issue in the present consolidated appeal were initiated by the Appellants, Fidelity and Guaranty Insurance Company, St. Paul Fire and Marine Insurance Company, Travelers Casualty and Surety Company of America and The United States Fidelity and Guaranty Company (collectively referenced as "Sureties") challenging the constitutionality of certain practices of the Appellee, the Mississippi State Tax Commission ("MTC") related to contractor tax bonds ("Riders"). (Rec02. 22-25) (Rec09. 142-167)[1]

On June 26, 2002, Fidelity & Guaranty Insurance Company ("F&G"), a surety company licensed and operating in Mississippi, filed suit in the Chancery Court of Hinds County challenging the constitutionality of the threat of the Mississippi State Tax Commission ("MTC") to seize its assets in Mississippi if it did not pay without question a sum the MTC alleged was due by its principal Aaim Construction, Inc. for alleged unpaid taxes, penalties and accrued interest. ("Aaim Action") (Rec02. 1-4) After discovery, the MTC moved for summary judgment (Rec02. 186). F&G filed a cross motion for summary judgment (Rec02. 43-185). On October 21, 2008, the Chancellor (Patricia Wise) overruled F&G's Motion and granted the MTC's. (Rec. Ex. Tab 3). F&G filed timely Notice of Appeal on November 19, 2008. (Rec. Ex. Tab 1)

On February 13, 2009, St. Paul Fire and Marine Insurance Company ("St. Paul"), Travelers Casualty and Surety Company of America ("Travelers"), F&G and United States Fidelity and Guaranty Company ("USF&G") filed another action in the same Court ("Multi-

[1] For the purposes of this brief, citations to the record on appeal are abbreviated as follows: "Rec02." indicates a citation to the clerk's papers by page number with Aaim Action; "Rec09" "Rec. Ex. Tab" indicates a citation to the Mandatory and Appellant's Record Excerpts by tab "TR 1" indicates a citation to the transcript of the hearing held on June 10, 2008; "TR 2" indicates a citation to the transcript of the hearing held on March 13, 2009. "Rec09." indicates a citation to the clerk's papers by page number in the Multi-party action.

party Action against the MTC on similar facts and similar issues but different sureties and bonded principals (Rec09. 1). An amended complaint was filed on March 10, 2009 (Rec09. 142). In response, on March 17, 2009 the MTC filed its Motion to Dismiss (Rec09. 424). After briefing and oral arguments, the Chancellor (William Hale Singletary) entered his order on July 9, 2009 granting MTC's Motion and dismissing the Plaintiff's Complaint (Rec. Ex. Tab 4). The Plaintiff's filed a timely Notice of Appeal on July 27, 2009.

Upon joint motion of all parties, these matters were consolidated for appeal. The issues presented in this consolidated appeal are now ripe for determination by this Court.

STATEMENT OF FACTS

This case involves the MTC's disregard for the rights of sureties to be treated fairly and to receive due process of law. The lower court's failure to require the MTC to operate within the constraints of these rights mandates reversal.

Overview

The Appellants herein are all related surety companies authorized to do and doing business as sureties for construction companies in the State of Mississippi.

Pursuant to § 31-5-57 Miss Code Ann (1972), every construction company which performs a public construction contract in excess of $25,000 in the State of Mississippi is required to post a performance and payment bond in the amount of the contract. Pursuant to § 27-65-21 Miss Code Ann (1972), the MTC also requires each of these bonds to contain a so-called "tax rider" by which, in addition to guaranteeing the contractor's performance of the construction contract, the surety also guarantees the contractor's payment of taxes that may be assessed against it by the State of Mississippi.

In each of the cases presented by these two consolidated actions, the MTC found that the respective contractors ("Principals") had failed to pay all of certain taxes assessed against them,

assessed additional taxes and then penalties based on the MTC judgment of the egregiousness of the contractor's default and interest running from the due date of the taxes.[2] (Rec09.145-146) (Rec. Ex. Tab 5) However, in none of the cases did the MTC give the respective sureties notice of the additional assessment or the contractor's failure to pay. (Rec09. 145) In several instances, the contractor's contested the assessments and were granted a hearing before the MTC. The surety was never given notice of these hearings. Importantly, the MTC has taken the position that even if the surety had been aware of the appeal hearings, it would not have been allowed to participate. (Rec09.144)

It is undisputed that in each of the cases that the first notice the sureties received of the assessments was often years after the fact and after substantial sums of penalties and interest had accrued on the balances. (Rec09. 144) It is also undisputed that even at that late date, the only notice the sureties received was a certified letter advising them that if they did not pay the then current amounts of taxes, penalties and interest within ten days, their assets in the State of Mississippi would be seized. (Rec09.168) This is not a matter of mere administrative mishandling. The MTC has taken the position that this late coming demand and threat of seizure is the only notice to which the sureties are entitled. (Rec09. 145)

Two other key factual points are important to a proper understanding of these cases. First, in each instance, the bonded contractors were no longer in business and their assets and business records had long since disappeared by the time the sureties received their first notice. In some instances, the contractor had gone out of business at the time of the assessment and thus gave no response to the MTC. (Rec09. 145) Second, in many of the cases, the MTC's

[2] The penalties are not mandatory but are discretionary both as to assessment and amount based on the MTC's view of the contractor's default. In none of these cases were the penalties assessed based on any conduct of the sureties.

assessment for which demand had been made against the sureties under threat of seizure of their assets, were admittedly incorrect. In one instance outlined in more detail below, had the surety simply paid the demand when made by the MTC, it would have paid over $263,000 which the MTC now admits was never due. (Rec09. 150) In other words, despite demanding immediate payment under threat of seizure, MTC subsequently conceded that its demand was in error.

Incredibly, the fundamental basis for the MTC's refusal to provide the sureties with any notice of the assessments until years after the fact is its contention that the sureties are not the "taxpayer". (Rec09. 145) (Rec09. 424) Thus, according to the MTC, the sureties are not entitled to anything but a ten (10) day letter before their assets are seized, sent long after the assessment of the taxes, penalties and interest.

It is undisputed in both cases that the MTC was very aware at all times of the existence of the sureties and how to contact them as they maintained copies of the Tax Riders in their files (Rec09. 144)

However, the MTC took the position in the courts below that the sureties were not entitled to any notice of the original assessments, had no right to challenge the assessments had they somehow learned of the assessment and had no right to participate in any hearings in the event the contractors may have appealed the assessments (Rec09. 145) Once the sureties received their ten (10) day demand letters, the MTC also took the position that the sureties had no legal right to challenge the assessments of additional taxes, the assessment of penalties, or the interest. (Rec09. 145) Importantly, even if the sureties had paid the demanded sums under protest, and it was later determined, as was often the case, that the assessments were in error, it was the position of the MTC that any refund of any sums overpaid by the sureties would have to be paid to the contractor/principal, not the surety which paid it. (Rec09. 157-158)

In the Aaim Action matter, after discovery, the matter proceeded to hearing on cross-motions for summary judgment (TR 1-46). The Chancellor granted MTC's motion and denied F&G's. In the Multi-Party action, the MTC filed its Motion to Dismiss thus admitting all well pled allegations of the Complaint (Rec09. 475). The Chancellor, however, granted the MTC's Motion and dismissed the Complaint (Rec09. 484)

The Aaim Bonds

On November 8, 2001, the State Tax Commission ("Commission") sent a letter to F&G demanding payment of $131,880.00 allegedly owed by its bonded contractor, Aaim Construction ("Aaim"), for unpaid sales taxes, penalties and interest assessed against Aaim (Rec02. 26) The letter stated that the "taxpayer," Aaim, had "been given ***due process*** of law to enable it to exercise all rights provided by the Sales Tax Law." (Rec02. 26) The letter threatened tax warrants and liens against F&G as surety for Aaim unless the demanded payment was not paid within ten (10) days. (Rec02. 26) This letter did not provide for any form of hearing and/or review prior to payment. (Rec02. 43) This letter was the ***first and only notice*** F&G had regarding the MTC's assessment against Aaim and/or its own potential liability as surety for Aaim. (Rec02. 67, 82) The time period for tendering the amount demanded was extended by agreement of counsel and F&G tendered a check in the amount of $131,880.00 under protest on December 18, 2001. (Rec02. 122)

Aaim applied for and was granted a state tax identification number in 1988. (Rec02. 123) In 1991, Aaim was audited by the Commission with no additional sales taxes assessed. (Rec02. 124) In 1994, the Commission again conducted an audit of Aaim. This time, the Commission assessed Aaim with an additional $16,205.23 in unpaid sales taxes and $2,877.70 in penalties and interest. (Rec02. 130) On April 23, 1998, the Commission again audited Aaim and, once again, assessed additional taxes, interest and a penalty of 15%. (Rec02. 132) The total

assessment for taxes, penalties and interest resulting from the 1998 audit was $81,654.00. In between the 1998 audit and the 2001 audit, which is the subject of this litigation, the Commission levied numerous tax liens and/or cited Aaim for various failures to accurately calculate and pay sales tax. (Rec02. 133)

On May 16, 2001, the Commission again audited Aaim. Once again, the Commission found that Aaim had not accurately reported sales tax and levied additional taxes in the amount of $116,479.00, interest in the amount of $20,770.00, and penalties in the amount of $29,120.00, or 25% of the unpaid taxes. (Rec02. 168) Importantly, MTC's auditor *only* kept copies of his own working papers and did not make copies of any of the documents underlying and/or justifying the amount he determined to be unpaid taxes. (Rec02. 87, 111) The auditor who determined the amount of the assessment is no longer employed by the Commission. (Rec02. 93, 104)

On June 21, 2001, Aaim requested a hearing before the MTC's Board of Review ("Review Board"). (Rec02. 178) Without notice to F&G, a hearing was held before the Review Board on August 2, 2001 wherein the MTC agreed to waive all penalties assessed and half of the interest assessed if Aaim paid the remaining sums within thirty (30) days. In the alternative, the MTC agreed to waive all penalties at the end of twelve months provided that Aaim paid the taxes and interest according to a payment schedule proposed by the MTC. (Rec02. 179) Aaim informed the MTC that it was financially unable to do either. The Board was well aware of F&G's interest in the proceedings. In the minutes of the August 2, 2001 hearing, the Review Board acknowledged that "all of the jobs in the assessment were bonded except for jobs representing $1,900.00 of the taxes due." (Rec02. 183) The Review Board decided that "collection should be made against the bonding company if the ***tax*** could not be collected from the taxpayer." (Rec02. 180) As noted, F&G had ***no notice*** of the August 2, 2001 hearing before

the Review Board and ***no opportunity to be heard.*** F&G was ***never*** advised of the Board's decision. (Rec02. 112)

In its rule 30(b)(6) deposition, the MTC admitted that each of the F&G bonds upon which demand was made pursuant to the November 8, 2001 letter had been filed with the Commission long before the 2001 audit. (Rec02. 180) The Commission further admitted that it knew how to contact F&G as its mailing address was clearly identified on the bonds. (Rec02. 57-60) Finally, the Commission admitted that it made no attempt whatsoever to contact F&G or to and give it notice of the hearing held on August 2, 2001, the offer to waive penalties and half of the interest made to Aaim pursuant thereto or Aaim's advice that it could not meet the payment plan. (Rec02 81, 82, 90, 106, 107, 112) As set forth above, the first time the MTC ***ever*** contacted F&G with regard to the assessment was on November 8, 2001, some three (3) months after the hearing and some seven (7) years after the MTC became aware that there was a problem with Aaim.

On December 18, 2001, F&G paid the $131,880.00 assessment "under protest" (Rec02. 24, 27). On June 26, 2002, F&G filed suit in the Chancery Court of Hinds County challenging the propriety of MTC's assessment. F&G sought a refund and an order directing MTC to release to F&G the entirety of Aaim's files so that F&G could investigate what, if any, taxes are actually due. (Rec02. 24 & 30). After discovery, both parties filed Motions for Summary Judgment (Rec02. 43 & 186)

On October 21, 2008, the Chancellor (Patricia Wise) overruled F&G's Motion and granted MTC's Motion. In her Judgment and Opinion, the Chancellor found that the MTC had satisfied its due process obligations when it notified only Aaim of the assessment, penalties and interest. (Rec. Ex. Tab 3) In fact, she specifically found that Aaim was the only party entitled to due process rights. (Rec. Ex. Tab 3) She further found that pursuant to § 27-3-73 Miss Code Ann., the MTC was prohibited from giving any notice to F&G as to tax assessments against

Aaim. (Rec. Ex. Tab 3) Finally, the Chancellor held that any relationship between the MTC and F&G was governed solely by the terms of the bond and the "tax rider" attached thereto and nothing in either document required the MTC to give F&G any notice of the assessment, penalties or interest until such time as the MTC decided to collect them from the Surety. (Rec. Ex. Tab 3)

The Pryor & Frazier Bonds

On or about May 31, 2002, St. Paul provided a performance and payment bond for its principal, Pryor & Frazier Construction, Inc. ("Pryor & Frazier") with regard to a construction project at the Jamie Whitten Delta State Research Center, Stoneville, Mississippi, being Bond Number ST9089. (Rec09. 170-171) Attached to that bond was the MTC's form Tax Rider dated June 5, 2002. (Rec09. 169) Seven years later, on January 8, 2009, the MTC forwarded to St. Paul, a demand that it pay the sum of $772,022.00, being $368.458.00 in allegedly unpaid taxes, $184,226.00 in penalties and $219,346.00 in interest, all allegedly owed the State of Mississippi by Pryor & Frazier. (Rec09. 168) The demand gave St. Paul, ten (10) days to pay the demanded sum in full or risk the seizure of its assets in the State of Mississippi (Rec02. 146, 148) The January 8, 2009 demand letter was the first notice provided to St. Paul that its principal, Pryor & Frazier, allegedly owed any unpaid taxes, penalties or interest. (Rec09. 146)

The penalties and interest demanded by the MTC's January 8, 2009 letter all accrued prior to St. Paul being given any notice of any tax delinquency (Rec09. 146) If audits were conducted and/or hearings held with regard to the assessment of the taxes against Pryor & Frasier, St. Paul was provided no notice of such audits or hearings. (Rec09. 147) Indeed, St. Paul had no notice of the delinquency of any taxes or the assessment of any penalties or interest with regard to its principal, Pryor & Frazier, until the January 8, 2009 letter (Rec09 147). Consistent with its treatment of F&G in the Aaim matter, it was the position of the MTC that St. Paul, as

surety, was not entitled to any notice of the delinquency of any taxes due the State of Mississippi by Pryor & Frazier, no notice or copies of any audits, or any notice of any hearing on any appeal of the assessment of taxes, penalties and interest, other than the January 8, 2009 letter. (Rec09. 147)

Sometime between the date of the assessments of the alleged taxes against Pryor & Frazier and the MTC's first notice to St. Paul, Pryor & Frazier ceased doing business. (Rec09. 147)[3]

The Frazier & Williams Bonds

Travelers issued performance bonds with Tax Riders on the Mississippi Tax Commission form to Frazier & Williams Construction, Inc. ("Frazier & Williams") regarding the following projects: (1) Fairpark Crossing Project-Tupelo, Mississippi on or about December 1, 2004; (2) Mississippi Employees Federal Credit Union-Tupelo, Mississippi on or about July 23, 2005 and (3) Santa Fe Restaurant-Tupelo, Mississippi on or about May 22, 2006. (Rec09. 173-175)

On or about October 27, 2008, the MTC forwarded to Travelers, a demand that it pay the sum of $200,921.00, in taxes, penalties and interest allegedly owed the State of Mississippi by Frazier & Williams or risk seizure of its assets in the State of Mississippi. (Rec09. 172) Thereafter, on or about December 29, 2008, the MTC forwarded to Travelers a "corrected claim" and demanded that it pay the sum of $87,656.60, being $67,160.60 in unpaid taxes, $2,305.00 in penalties and $18,191.00 in interest allegedly owed by Frazier & Williams. (Rec09. 149, 176) This notice thus reduced MTC's claim by $113,264.40. The demand gave Travelers, ten (10) days to pay the demanded sum in full or face seizure of its assets in Mississippi. (Rec09. 149, 176)

[3] Although outside the record, on June 22, 2009, while awaiting the Chancellor's decision, St. Paul paid, "under protest," the $368,450 in taxes assessed.

The October 27, 2008 and December 29, 2008 demand letters were the first and only notice provided to Travelers by the MTC that its principal, Frazier & Williams, allegedly owed any amount of unpaid taxes, penalties or interest. (Rec09. 149) Further, all penalties and interest accrued prior to Travelers having received any notice whatsoever. Had Travelers paid the $200,921.00 demanded in the MTC's October 27, 2008 demand letter, it would have overpaid the State of Mississippi by $113,264.40.

Sometime between the date of the above referenced assessments against Frazier & Williams and MTC's first notice to Plaintiff, Travelers, Frazier & Williams ceased doing business. (Rec09.151)[4]

The Cobb Land Development Bonds (I)

On or about October 19, 2000, F&G issued a performance bond and Tax Rider for the Tunica Airport Site Preparation contract for its principal, Cobb Land Development, Inc. ("Cobb"). On or about February 19, 2001, F&G issued a performance bond and Tax Rider for Cobb for the Jennings Biozone Hazard Mitigation Project. (Rec09. 190) The MTC claims that, in addition to the above, F&G also issued a Tax Rider for Cobb in July 2000 for the New Noxubee High School Site Development Package. (Rec09. 152) However, F&G has found no evidence that any such bond was ever issued and the MTC failed to offer an executed copy of the same in the proceedings below. (Rec09. 152, 186) On or about July 29, 2004, the MTC made demand upon F&G for the sum of $398,074.00, being $328,071.00 in taxes, $37,195.00 in interest and $32,808.00 in penalties related to the Noxubee County High School, Jennings Biozone Hazard Mitigation Project and the Tunica Airport. The demand letter gave F&G ten

[4] Although outside the record, on January 26, 2010, St. Paul paid, "under protest", the $67,160.10 in taxes assessed.

(10) days to pay the demanded sum in full or face seizure of its assets in Mississippi (Rec09. 153 & 203)

As with other cases, the July 29, 2004 demand letter was the first notice provided to F&G by the MTC that its principal, Cobb, owed any unpaid taxes, penalties or interest. (Rec09. 153) The penalties and interest demanded by MTC July 29, 2004 letter all accrued prior to F&G being given any notice by MTC of any tax delinquencies by Cobb. F&G had no notice of any audits or hearings related to Cobb's failure to pay.

At all times, it has been the position of the MTC that F&G was not entitled to any notice of the delinquency of any taxes, any notice or copies of any audits, or notice of any hearings on any contest of the assessment against Cobb other than the July 29, 2004 letter (Rec09. 153). The MTC also took the position that F&G is not entitled to any manner of hearing to contest the assessment after notification. (Rec09. 153) Indeed, F&G demanded a hearing in order to contest the assessment of the taxes allegedly due for Cobb, but the same was refused by the MTC (Rec02. 153) However, by agreement of the Parties, collection efforts on this matter were held in abeyance pending the lower court's decision in the Aaim action. (Rec09. 154)

As with other cases in this consolidated appeal, it is undisputed that the MTC's assessments are often characterized by significant errors and miscalculations. Although the MTC refused to allow F&G an opportunity to challenge the Cobb assessment, while the Aaim case was pending, the MTC determined that there were, in fact, significant errors in the audit and assessment. (Rec09. 154, 225-226) In March 2006, the MTC "adjusted" its original assessment against Cobb from $398,074 downward to $273,380 or a reduction of $124,694 from its original assessment. (Rec09. 154) Thus, if F&G had paid the original assessment of $398,074.00, it would have overpaid the MTC by over $124,000.00. By January of 2007, Plaintiff, F&G, had

identified other issues that could indicate errors in the MTC's original assessment against Cobb. (Rec09. 227-230)

On November 28, 2008, after the Chancellor's ruling in the Aaim action, the MTC issued yet another "corrected" demand on F&G to pay an assessment of $647,407.00 or $374,027 more than its previous assessment. (Rec09. 231) In this correspondence, the MTC threatened the imposition of liens and/or the issuance of warrants for the seizure of F&G's property if the $647,407 was not paid. (Rec09. 231) Amazingly, only five (5) days later, on December 2, 2008, the MTC forwarded to counsel for F&G, a third "corrected claim on F&G's bond for the sum of $383,838, or $263,569 less than its November 28, 2008 demand. (Rec09. 231)[5] Even more amazingly, only two (2) days later, on December 4, 2008, the MTC advised F&G that the assessment had been amended a ***fourth time*** to the sum of $270,277, or $113,561 less than its December 2, 2008 assessment. (Rec09. 232) On or about December 16, 2008, F&G, paid the full sum of $270,277.00 under protest and with full reservation of its rights to contest both the underlying tax liability and any penalties and interest which were assessed against it. (Rec09. 155, 235-236)

Thus, although on July 29, 2004 the MTC demanded that F&G pay $398,074 within ten (10) days or face seizure of its assets, over the course of the next four (4) years, the MTC revised that assessment four times because of admitted errors in its calculations. (Rec09. 156) These "corrected" assessments ($647,407 to $383,838 to $270,277) occurred within the course of only seven (7) days. Even if the MTC's three (3) other amended assessments are ignored, if F&G, had paid the MTC's first erroneous demand for $398,074, it would have overpaid by more than $127,000 the tax, penalties and interest the MTC finally concluded was actually due.

[5] The MTC graciously agreed to give F&G until December 16, 2008, to pay the claim before its assets were seized.

Sometime between the date the MTC first made demand upon Cobb for additional taxes and the July 29, 2004 demand on F&G, Cobb ceased doing business.

The Cobb Land Development Bonds (II)

On or about October 19, 2000, F&G issued a Tax Rider for the Tunica Airport site preparation contract and related performance bond for Cobb. (Rec09. 186) On or about February 19, 2001, F&G issued a Tax Rider for Cobb for the Jennings Biozone Hazard Mitigation Project. (Rec09. 190) As a result of a follow-up audit by the MTC regarding payments on jobs received by Cobb after the conclusion of the last audit, the MTC made a separate and independent assessment of and claim for unpaid contractor's tax and the related interest and penalties against Cobb. (Rec09. 203)

Over eight (8) years after the original bond was issued, on January 16, 2009, the MTC made demand upon F&G for the sum of $4,451.00, being $2,881.00 taxes, $1,282.00 interest and $288.00 in penalties. (Rec09. 280) The demand letter gave F&G ten (10) days to pay the demanded sum in full related to the Jennings Biozone Hazard Mitigation or face seizure of its asserts in the State of Mississippi. However, the bond attached was for the construction project at the Tunica Airport. (Rec09. 281) Notwithstanding the error, the January 16, 2009 demand letter was the first notice provided to F&G by Tax Commission that its principal, Cobb, owed any unpaid taxes, penalties or interest for either project. The penalties and interest demanded in the MTC's January 16, 2009 letter accrued prior to F&G being given any notice of these tax delinquencies by Cobb, any audits of Cobb and/or hearings held with regard to the amount assessed. (Rec09. 158)

At all relevant times, the MTC has taken the position that F&G was not entitled to any notice of the delinquency of any taxes, any notice or copies of any audits, or notice of any hearings on any contest of the assessment against Cobb other than the January 16, 2009 letter.

(Rec09. 282) Further, the MTC has refused to even permit a hearing after demand was made on the bond to contest the accuracy of the assessment. (Rec09. 158, 282-295) F&G demanded a hearing in order to contest the assessment of the taxes allegedly due for Cobb, but was refused by the MTC. (Rec09. 282-295) Moreover, it was the MTC's position that any overpayment by F&G would be refunded to Cobb. (Rec09. 158)

The Howell's Nursery & Landscape Bonds

On various dates F&G issued bonds and accompanying Tax Riders for various projects undertaken by its principal, Howell's Nursery & Landscape, Inc ("Howell's Nursery") (Rec09. 160, 237-263) On or about December 21, 2006, the MTC made demand upon F&G, for the sum of $43,109.05, being unpaid sales taxes in the amount of $31,542.05, penalties in the amount of $3,154.21 and interest in the amount of $8,412.79 assessed against Howell's Nursery. The demand letter gave F&G ten (10) days to pay the demanded sum in full to avoid the seizure of its property in the State of Mississippi. (Rec09. 160 & 264) As with the other demands, this was the first notice of any audit of or assessment against Howell's Nursery. (Rec09. 161)

On or about January 29, 2007, counsel for F&G demanded an opportunity to examine the basis for the assessment and a hearing before the MTC's Review Board to present a defense. Counsel also requested a copy of the auditor's complete file of the Howell's Nursery assessment so that they could investigate the matter. (Rec09. 265) As was its policy, the MTC refused to allow F&G an opportunity to examine the basis for the assessment, denied F&G a hearing before the Review Board and refused to provide copies of the MTC's file regarding the Howell's Nursery assessment. The MTC further advised that it did not consider F&G, as a "taxpayer" under Mississippi law and thus, not entitled to a hearing on the assessment. (Rec09. 161 & 266)

Pursuant to an agreement between the Parties, collection efforts on this matter were held in abeyance pending the Chancellor's decision in the Aaim case. During the interim, on

November 24, 2008, the MTC "corrected" its assessment on these bonds and increased its demand to $51,940.82 and again threatened to file tax warrants or liens to secure payment by way of seizure of F&G's property. (Rec09. 161 & 267) If F&G had paid MTC's initial assessment, it would have overpaid by $8,831.77. On December 29, 2008, Travelers paid the full amount of $51,940.82, "under protest". (Rec09. 162 & 268-269)

Sometime between the date of any of the assessments against Howell's Nursery and the MTC's first notice to Plaintiff, F&G, Howell's Nursery ceased doing business.

The Avant Garde bond

On or about September 28, 2000, United States Fidelity and Guaranty Company ("USF&G") provided a performance bond with Tax Rider bond for Avant Garde Contractors, Inc. ("Avant Garde") with regard to the construction of Catherine's Retail Store, Metro Center Mall-Jackson, Mississippi. (Rec09. 164, 271) Almost four (4) years later on or about August 26, 2004, the MTC forwarded to USF&G a demand that it pay the sum of $8,201.82, being $5,174.65 in taxes, $517.46 in penalties and $2,509.71 in interest, all allegedly owed the State of Mississippi by Avant Garde. (Rec09. 270) The demand gave USF&G, ten (10) days to pay the demanded sum in full or face seizure of its property in the State of Mississippi. (Rec09. 164, 270) Pursuant to the agreement between the parties, all collection efforts in this matter were held in abeyance pending the Chancellor's decision in the Aaim case.

On or about November 25, 2008 the MTC recalculated its interest claim and asserted its demand that USF&G pay the sum of $10,633.91. (Rec09. 277) As with the other bonds at issue in this case, the August 26, 2004 demand letter was the first notice provided to USF&G by the MTC that Avant Garde allegedly owed any unpaid taxes, penalties or interest. (Rec09. 165) Likewise, it is the position of the MTC that USF&G, as surety, was not entitled to any notice of the delinquency of any taxes due the State of Mississippi by Avant Garde, no notice or copies of

any audits, or any notice of any hearing on any contest of the assessment of taxes, penalties and interest, other than the August 26, 2004 letter and no entitlement to a hearing to challenge the assessment. (Rec09. 165) On or about January 7, 2009, USF&G, paid to the sum of $10,633.91 under protest and with full reservation of rights. (Rec09. 278-279)

The Admitted Errors by MTC and the Importance of Notice

The importance of notice and a right to challenge the assessments before the Sureties are obligated to pay, and certainly before any penalties and interest accrue, is clearly demonstrated by the sheer amount of "corrections" made by the MTC in these cases after demand was made on the Sureties. MTC "corrected" its original demand on the Sureties in the Pryor & Frazier, Cobb I, Howell's Nursery and Avant Garde claims. In total, over $886,818.66 in adjustments up or down were made to the original assessments. Although no "corrections" were issued by MTC with regard to the Aaim assessment, there is a discrepancy between the amounts set forth in the letter for taxes, interest and penalties and how the amount paid by F&G was actually credited by the MTC. (Rec02. 435-437) (Rec. Ex. Tab 5) The discrepancy was never explained by the MTC. MTC has also taken the position that since the sureties were not the "taxpayers," any refunds due because of overpayment must be refunded to the contractor/principals, even though the surety actually paid the assessment and even though contractor/principals were out of business by the time any notice was given to the sureties. (Rec09. 142)

The Total Claims

All totaled in these combined seven assessments represent a total claim against these sureties of $1,328,861.33. Of this sum, over $784,000 represents questionable tax assessments that the sureties have been prohibited from challenging even though the MTC admits that over $886,000 in errors have been made on these files. Over $233,000 of the total represents penalties

arbitrarily assessed against the Principals based on unknown and according to the MTC, unchallengeable, allegations of the Principals' negligence, not the Sureties. And, over $311,000 of the total represents interest for non-payment of the assessments claimed against the Sureties all of which had accrued before they ever had notice of any demand for payment of the taxes.

The Litigation

On February 11, 2009 St. Paul, Travelers, F&G and USF&G filed suit in the Chancery Court of Hinds County, Mississippi, again challenging the propriety of the MTC's assessments. Specifically, for each of the above, the Sureties sought a refund of any taxes, penalties and interest they had paid "under protest", an injunction requiring MTC to provide all file documents in its possession regarding the assessments and after an opportunity to examine these records, a right to a hearing to contest any assessment of taxes they asserted were not due. The Sureties also sought an injunction prohibiting MTC from taking any actions to attempt to collect penalties or interest before the date of first notice to the sureties (Rec09. 142)

On March 17, 2009, the MTC filed its Motion to Dismiss the Amended Complaint (Rec02 424). Under *Newell v. Jones County*, 731 So.2d 580 (Miss. 1980), all well pled facts asserted in the Amended Complaint were assumed to be true.

On July 9, 2009 the Chancellor (Singletary) entered an order dismissing the Sureties' complaint. (Rec. Ex. Tab 4)The Chancellor found that the sureties did not establish the prerequisites for injunctive relief, primarily a likelihood of success on their merits in light of Chancellor Wise's earlier decision in Aaim. In addition, the Chancellor concluded that the Sureties were entitled to no other notice than what they had been given, that their rights and obligations were defined by the contract (*i.e.* the bonds) and that the sureties were not

"taxpayers" and did not stand in the place of their principals the defaulting contractors. (Rec. Ex. Tab 4)

SUMMARY OF THE ARGUMENT

This case is about the basic principal of fairness embodied in the law of due process. The question presented in this case is: are the Tax Commission's actions fair? The Tax Commission ignored the constitutional issues presented by this case in the proceedings below. Likewise, both trial courts failed to even address the critical due process issues presented in these consolidated cases. This Court should not follow suit.

The United States Constitution's guarantee of substantive due process is the very essence of fairness which "goes beyond the specific provisions of the Bill of Rights [and] embodies 'a conception of fundamental justice." *Sotto v. Wainwright*, 601 F. 2d 184, 190 (5th Cir. 1979). Where a fundamental right is involved, as in the present case, governmental acts adversely affecting these rights must be "narrowly tailored to serve a compelling state interest." *Mississippi High School Activities Ass'n, Inc. v. Coleman*, 631 So. 2d 768, 774 (Miss. 1994). The MTC's act of forcing the Sureties to pay interest and penalties which accrued as a result of another's alleged wrongdoing clearly serves no compelling interest and was certainly not narrowly tailored to serve any such interest.

In addition to substantive due process, the United States Constitution includes the guarantee of procedural due process which prohibits the state from depriving a citizen of a protected interest without giving that citizen the opportunity to be heard "at a meaningful time and in a meaningful manner." *Mississippi Bd. of Veterinary Medicine v. Geotes*, 770 So.2d 940, 943 (Miss. 2000) (citing *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976)). Under the policies of the MTC, the Sureties were excluded from participating in and kept ignorant of the pre-deprivation "due process" afforded the Principals, even though the Sureties interests were likely to be adversely impacted and their identities were clearly known. If that were not enough, the Sureties were also prohibited from any post-deprivation process after demand was made on the

bonds. The numerous mistakes and recalculations regarding the claims at issue in this case demonstrate that risk of erroneous deprivation is extremely high. By policy of the MTC, Sureties are denied the opportunity to be heard "at a meaningful time and in a meaningful manner" regarding claims on Tax Riders. That is certainly so in these cases, Accordingly, the taxes, penalties and interest exacted from the Sureties were improper and, pursuant to Miss. Code Ann. 27-65-47, the Sureties are entitled to a refund. *See also, H.J. Wilson Co., Inc. v. State Tax Comm'n of State*, 737 So.2d 981, 999 (Miss. 1998).

Finally, even if the concept of due process is inapplicable and the Sureties claims are just contract claims, as asserted by the MTC and held by the lower courts, these decisions must be reversed. The trial courts' rulings in favor of the MTC were contrary to the long-established precedents of this Court regarding the payment of interest by Sureties, the narrow construction of penalties and this Court's precedent requiring that applicable Mississippi law be read into contractual terms. Further the lower courts found language so muddied and unclear that the MTC could not even directly quoted to the provisions it relied upon, to be "clear and unambiguous." Contrary to established Mississippi law, these ambiguous contracts should have interpreted against the drafter, the MTC, and in favor of the Sureties, who had no power to change these terms.

For these reasons, the Sureties ask that the opinions at issue in this case be reversed and judgment rendered in their favor.

STANDARD OF REVIEW

This appeal involves the grant of summary judgment and the grant of a motion to dismiss. Grant or denial of either type of motion is reviewed pursuant to the *de novo* standard of review. *Harris v. Miss. Valley State Univ.*, 873 So. 2d 970, 988 (Miss. 2004); *Brown ex rel. Ford v. J.J. Ferguson Sand & Gravel Co.*, 858 So.2d 129, 130 (Miss. 2003).

ARGUMENT

I. THE COURT BELOW ERRED IN FINDING NO VIOLATION OF DUE PROCESS.

A. Not Just A Contract Case

Both trial courts side-stepped the merits of the Sureties' constitutional claims by finding the present dispute to be nothing more than a contract dispute. (Rec. Ex. Tabs 3, 4) On the contrary, this is a constitutional rights case, ***not*** a contract dispute and the courts below erred in failing to address the constitutional claims presented.

In the proceedings below, the MTC admitted that the contracts at issue, the language included therein and its actions taken pursuant to those contracts are all a function of state action. (Rec02. 486) There was no dispute regarding the role state action played in the creation of the contracts at issue, the language included therein and the fact that the exaction of money from the Sureties by the MTC was pursuant to that state action. Indeed, the MTC pointed out that the tax bonds at issue were ***mandated*** by statute and that the penalties and interest collected from the Sureties are provided for by statute. (Rec02. 486) The MTC also freely admits that all tax bonds must ***be approved by the Tax Commissioner***. (Rec02. 486) Indeed, the MTC acknowledges that it is responsible for the language included in the contracts at issue in these consolidated cases. (Rec02. 339-334) Finally, the MTC's written demands to the Sureties were expressly made under color of law and threatened ***statutory*** sanctions for any failure to comply. (Rec02. 339-334)

It is clear that the very existence of the Riders and the language employed in them is a product of state action necessarily invoking constitutional rights. Notwithstanding, the MTC takes the position that the Sureties were not entitled to due process in the MTC's demands against the Riders. This position is contrary to both state and federal law and cannot be sustained.

B. The Sureties Were Entitled to Due Process.

1. Sureties' right to substantive due process was violated.

The Fourteenth Amendment to the United States Constitution prohibits a state from depriving any person of "life, liberty or ***property*** without due process of law." When the State of Mississippi, through the MTC, exacted taxes, penalties and interest from the Sureties for the Contractors' failure to timely pay sales taxes, it deprived the Sureties of ***property***.

"Where a right is either explicitly or implicitly guaranteed by the constitution, that right is 'fundamental.'" *King v. Mississippi Dept. of Corrections*, 721 So.2d 1126, 1129 (Miss. Ct. App. 1998)(citing *San Antonio Indep. Sch. Dist. v. Rodriguez,* 411 U.S. 1, 33-34, 93 S.Ct. 1278, 36 L.Ed.2d 16 (1973)). State action which deprives an individual of a fundamental right is subject to strict scrutiny. *Wells v. Panola County Bd. of Ed.*, 645 So.2d 883, 893 (Miss. 1994). Strict scrutiny prohibits "governmental infringement of fundamental liberty interests 'unless the infringement is narrowly tailored to serve a compelling state interest.'" *Mississippi High School Activities Ass'n, Inc. v. Coleman By and on Behalf of Laymon*, 631 So.2d 768, 774 (Miss.1994)(citing *Reno v. Flores,*113 S.Ct. 1439, 1447 (1993)). Inasmuch as the right to property is expressly protected by the United States Constitution, the MTC's act of depriving the Sureties of its property is, therefore, subject to strict scrutiny.

The purpose for exacting penalties from taxpayers who fail to follow the tax code is "to induce prompt payment of taxes . . ." with the threat of punishment for the failure to do so. *Broadhead v. Monaghan*, 117 So. 2d 881, 888 (Miss. 1960). *See also, Boyd v. Coleman*, 111 So. 600, 604 (Miss. 1927). The "evil" which the penalty at issue seeks to prevent and/or punish is failure to timely pay taxes. *Broadhead*, 117 So. 2d at 888. The "evil" was committed by the Principals, not the Sureties. It was undisputed in the proceedings below that the Sureties ***had no notice*** of the audits, ***no notice*** of any Review Board hearings and ***no notice*** of any past failures

on the part of the Principals to properly pay sales taxes. (Rec02. 81-82, 90, 98, 106-112) (Rec09. 144, 145, 424-429) Clearly, the penalties paid by the Sureties do not further any legitimate and/or compelling state interest.

The right to due process "goes beyond the specific provisions of the Bill of Rights [and] embodies 'a conception of fundamental justice.'" *Sotto v. Wainwright*, 601 F.2d 184, 190 (5th Cir. 1979)(citation omitted). In short, it requires ***fairness*** on the part of the government. This concept of fairness is evident in this Court's precedent.

Mississippi law provides that a surety is ***only*** liable for interest that accrues as a result of its ***own failure*** to pay, and not as a result of any other party's failure. *State v. Moody*, 198 So. 2d 589, 591-92 (Miss. 1967). This principal is based on fairness. Likewise, under Mississippi law, penalties are strictly construed and are ***not*** to be imposed by implication. *Winter v. Hardester*, 98 So. 2d 629 631 (Miss. 1957). This is so because it is fundamentally ***unfair*** to punish one for the misdeeds of another. The *Moody* case is particularly clear on this point. Specifically, the authority relied upon by this Court in *Moody* recognized:

> It seems particularly inept to say of a surety on an official bond, ***who not only does not know*** of the embezzlement ***but whose facilities*** for discovering that an embezzlement has been committed ***are so inadequate as compared with those of the obligee***, that it was at fault in not paying the money from the time of the several acts of embezzlement . . .

Moody, 198 So. 2d at 591 (citing *State v. American Surety Co.*, 24 P.2d 267, 269 (N.M. 1933)(emphasis added).

The record in this case reveals that MTC was in a much better position than the Sureties to determine whether or not the Principals were under reporting sales taxes. (Rec02. 124-167) Likewise, the frequency with which the Commission audited the Principals was and is entirely within the MTC's control and at its discretion. (Rec02. 69, 109) Under this system, the MTC can wait three, four and even five years between audits while interest continues to accrue. It is the

MTC's position that it can wait and allow penalties and interest to accrue, then demand all of this interest from a surety ***without notice*** of any audit, ***without notice*** of any hearing regarding the audit and ***without any opportunity*** whatsoever to participate in the "process" afforded to the Principal. This is patently unfair. It is clear that exacting penalties from the Sureties does absolutely nothing to further any recognized governmental interest. Certainly, this action of the MTC does not meet the requirements of strict scrutiny.

Accordingly, the court's below erred in failing to find that the MTC's actions and policies violated the Sureties' right to substantive due process.

2. Sureties right to procedural due process was violated.

In addition to the substantive guaranties discussed above, the Due Process Clause "grants the aggrieved party the opportunity to present his case and have its merits fairly judged." *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 433 (1982). This is known as procedural due process and it prohibits the state from depriving a citizen of a protected interest without giving that citizen the opportunity to be heard "at a meaningful time and in a meaningful manner." *Mississippi Bd. of Veterinary Medicine v. Geotes*, 770 So.2d 940, 943 (Miss. 2000)(citing *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976)).

i. Sureties' interests were adversely affected

In *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), the United States Supreme Court stated that the Due Process Clause requires notice and an opportunity to be heard where interests may be adversely affected by government action. *Mullane*, 339 U.S. at 313. The notice must be "reasonably calculated, under all the circumstances, to apprise ***interested parties*** of the pendency of the action and afford them the opportunity to present their objections." *Id.* at 314 (emphasis added). In interpreting *Mullane* and other United States Supreme Court precedent, the United States Court of Appeals for the Fifth Circuit observed: "By requiring

notice and an opportunity to be heard, the Due Process Clause permits persons ***whose interests may be adversely affected*** by government decisions to participate in those decisions." *Matthias v. Bingley*, 906 F.2d 1047, 1052 (5th Cir. 1990)(emphasis added).

This Court has previously recognized the applicability of due process regarding statutory provisions related to constructions bonds. *American Fidelity Fire Ins. Co. v. Athens Stove Works, Inc.*, 481 So.2d 292, 295 (Miss. 1985)("The statutory scheme found in the private bond statute falls short of conformity with this standard of hornbook constitutional law."). Courts in sister jurisdictions have expressly found that sureties (in the context of bail bonds) are entitled to pre and post deprivation hearings on bonds issued by them where the governmental authority makes a claim for the bonded individual's default. *See, State v. Polanca*, 753 A.2d 1170, 1173-74 (N.J.Super, 2000) ("There can be no dispute here that a corporate surety, like IFI, is entitled to both a pre-deprivation hearing and post-deprivation hearing . . ."); *State v. Mitchell*, 337 So. 2d 1186, 1188 (La. 1976) *See also, Edmonson v. County of Van Zandt* 1994 WL 24921 at *2 (5th Cir. 1994)("[w]e need not determine what process was due to agree with the district court that a due process violation occurred. Sheriff Jordan's policies provided no process either pre- or post-deprivation."). Mississippi statutorily provides for both pre- and post- deprivation notice and/or hearings with regard to bail bond sureties. *See*, Miss. Code Ann. § 99-5-25.

There can be no doubt that the Sureties' interests were at risk from the moment the MTC decided to conduct audits of the Principals. Even were this not the case, the Sureties interests were clearly at risk when the MTC determined that assessments were warranted against the Principals. The MTC admits that knew it would turn to the Sureties to pay the assessments at issue should the Principals fail to do so. (Rec02. 179-180, 183) Notwithstanding, the MTC takes the position that Sureties are not entitled to any form of procedural due process to participate in or challenge governmental actions. This is simply incorrect.

Under *Mullane*, ***any*** entity whose interests ***may*** be adversely affected by governmental action is entitled to the protections of procedural due process. *See, Mullane*, 339 U.S. at 313; *Matthias*, 906 F.2d at 1052. This protection is not limited to individuals but also applies to companies like the Sureties. *See e.g., Potashnick v. Port City Const. Co.*, 609 F.2d 1101, 1119 (5th Cir. 1980). Indeed, the United States Supreme Court has recently reaffirmed that a corporation's rights are no less than an individual citizen's rights under the United States Constitution in the context of a First Amendment case. *See, Citizens United v. Federal Election Com'n*, 2010 WL 183856 at *29-*30 (U.S. 2010).

Under the procedural protections afforded by the Due Process Clause, the Sureties were clearly entitled to notice of the assessments and the same right to a hearing afforded the Principals. This notice and opportunity would not have burdened the Commission in any way.

ii. what process is due?

Having established that the Sureties were entitled to procedural due process, the question then becomes: what process was due? The United States Supreme Court set forth the analysis for this determination in its landmark decision in *Mathews v. Eldridge,* 424 U.S. 319, 333 (1976). As recognized by the Court, the following factors apply:

> First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.

Hinds County School Dist. Bd. of Trustees v. R.B. ex rel. D.L.B., 10 So.3d 387, 399 (Miss. 2008)(citing *Matthews v. Eldridge*, 424 U.S. 319, 335 (1976)). Application of these factors reveal the error of the MTC's position and the lower courts' rulings.

First, the MTC is, itself, a governmental body. As such, its actions are official action. The MTC's claims against the Sureties were made pursuant to Riders which the MTC drafted, approved and required through application of Mississippi statutes. (Rec02. 481) The written demands for money threatened liens and/or warrants against the Sureties property within the state under statutory authority. (Rec. Ex. Tab 5) Clearly, the Sureties' private property, in the form of both the money demanded and other property threatened with tax liens and warrants, were affected by the official action of the MTC acting under color of law.

Second, the MTC admits that it knew how to contact the Sureties as this information is included on the Riders also kept on file and could have done so for the price of a stamp. (Rec02. 56-60, 91) Notwithstanding, it is the policy of the MTC not to notify the surety of any audit, assessment or hearing until after "all due process" is exhausted by the Principal. (Rec02. 81-82, 90, 106-107, 112) (TR1 22-23) Clearly, affording the Sureties notice and an opportunity to be heard concurrently with the Principal would pose no burden whatsoever on the MTC.[6]

Third, and most importantly, the record in these consolidated appeals reveals that the risk of erroneous deprivation, absent some form of procedural due process, is extremely high. There are numerous examples throughout the record in these cases revealing that ***MTC can, and often does, make mistakes in assessments and calculations.***

Mistakes in the Cobb Land Development Bond demands

[6] After its Rule 30(b)(6) deposition in the Aaim case, the MTC raised the argument that certain confidentiality statutes prohibit the MTC from providing any notice to the Sureties until demand under the Rider is made. (Rec02. 52, 475-477) As addressed in greater detail below, this argument is pre-textual, inconsistent with the statutory language actually relied upon by the MTC and requires an unconstitutional interpretation of the relevant statutes. *See, infra.* Furthermore, this argument directly contradicts the MTC's Rule 30(b)(6) deposition wherein its designee testified that she knew of no statutory prohibition to copying the Surety on the audit notice letter or of the assessment. (Rec02. 82)

On February 19, 2001, Appellant, F&G issued a Tax Rider for Cobb for the Jennings Biozone Hazard Mitigation Project. (Rec09. 186-193) The MTC claims that F&G, also issued a Tax Rider for Cobb in July 2000 for the New Noxubee High School Site Development Package. (Rec09. 152) F&G has found no evidence that any such bond was ever issued and the Tax Commission failed to offer an executed copy of the same in the proceedings below. (Rec09. 152, 194-202)

On July 29, 2004, the Tax Commission made demand upon F&G, for the sum of $398,074.00, being $328,071.00 in taxes, $37,195.00 in interest and $32,808.00 in penalties related to the Noxubee County High School, Jennings Biozone Hazard Mitigation Project and the Tunica Airport. The demand letter gave Plaintiff, F&G, ten (10) days to pay the demanded sum in full. (Rec09. 203)

As with the other cases, the July 29, 2004 demand letter was the first notice provided to F&G by the Tax Commission that its principal, Cobb, owed any unpaid taxes, penalties or interest. The penalties and interest demanded by Tax Commission July 29, 2004 letter accrued prior to Plaintiff, F&G, being given any notice by Tax Commission of any tax delinquencies by Cobb. F&G had no notice of any audits or hearings related and no notice of the delinquency of any taxes or the assessment of any penalties or interest with regard to its principal, Cobb, until July 29, 2004. (Rec09. 152-155) F&G demanded a hearing in order to contest the assessment of the taxes allegedly due for Cobb, but the same was refused by the MTC pursuant to its policy that only the Principal be afforded due process. (Rec09. 153)

Thereafter, the MTC determined that there were, in fact, major errors in the Cobb audit and assessment. (Rec09. 227-228) In March 2006, MTC adjusted the original July 29, 2004 assessment against Cobb from $398,074.00 to $273,380.00 or reduction of $124,694 from its

original assessment. (Rec09. 154) If F&G, had paid the original assessment of $398,074.00, it would have overpaid the Tax Commission by over $124,000.00.

By January of 2007, F&G, had identified issues indicating errors in the MTC's original assessment against Cobb. (Rec09. 227-228) Later, the MTC issued a new demand on Plaintiff, F&G, to pay an assessment of $647,407.00 or $324,027 more than its previous assessment. (Rec09. 231) In its correspondence, the MTC threatened the imposition of liens and/or the issuance of warrants for the seizure of Plaintiff, F&G's property if the $647,407.00 was not paid. (Rec09. 231) On December 2, 2008, the MTC forwarded to counsel F&G, yet another corrected claim this time for the sum of $383,838.00. (Rec09. 232-233) Two days later, the MTC advised F&G that the assessment had been amended ***yet again*** to the sum of $270,277.00. (Rec09. 234)

If F&G had paid the MTC's first erroneous demand for $647,407.00, it would have overpaid by more than $363,000.00. If Plaintiff, F&G, had paid the Tax Commission's second erroneous demand of $383,838.00, it would have overpaid by more than $113,000.00. But F&G would have had no recourse because it is the Tax Commission's position that any overpayment by the F&G would ***only*** be refunded to Cobb, ***not*** F&G. (Rec09. 155)

Mistakes in the Frazier & Williams Bonds

On October 27, 2008, the MTC forwarded to Appellant, Travelers, a demand that it pay the sum of $200,921.00, in taxes, penalties and interest allegedly owed the State of Mississippi by Frazier & Williams. (Rec. Ex. Tab 5) Thereafter, on December 29, 2008, the MTC forwarded a "corrected claim" and demanded that it pay the sum of $87,656.60, being $67,160.60 in unpaid taxes, $2,305.00 in penalties and $18,191.00 in interest allegedly owed by Frazier & Williams. (Rec09. 176) The original demand only gave Travelers, ten (10) days to pay the demanded sum in full. Had Travelers paid the $200,921.00 demanded in the Tax Commission's October 27, 2008 demand letter, it would have overpaid the State of Mississippi. As noted above, under the

MTC's policy, any such overpayment by Travelers would be refunded to Frazier & Williams, ***not*** Travelers. (Rec09. 155)

Mistakes in the Aaim Assessment

The demand letter sent to Appellant, F&G by the MTC on November 8, 2001 demanded payment in the total amount of $131,880.00. (Rec. Ex. Tab 5) The letter also indicated that $91,091.00 of this amount was for "tax" and $40,789.00 was for "penalty" and "interest." (Rec. Ex. Tab 5) However, when the $131,880.00 payment was made by F&G under protest, the Commission credited this amount as $81,990.00 for "tax" and $49,890.00 for "damages." (Rec02. 435-437) According to the audit upon which the Aaim assessment was based, $49,890.00 is the total amount of penalty and interest assessed against Aaim in the 2001 audit for ***all*** jobs – not just those bonded by F&G. (Rec02. 438-443)

Clearly, the MTC is prone to making mistakes. Its mistakes can cost the Surety hundred of thousands, if not millions of dollars. Yet, the MTC offers the Surety no process at all either before or after a claim is paid, to challenge or even examine the accuracy of the MTC's demand. Even if a mistake is somehow discovered and brought to the MTC's attention, if the Surety has already paid, the MTC will reimburse the Principal ***not the Surety.*** In every instance in these consolidated cases, the Principals are out of business. The risk of erroneous deprivation is exceedingly high. The complete absence of process clearly fails to comply with the requirements of *Matthews*. Further, and in light of the foregoing, pre-deprivation process is required by due process and the precedent of this Court.

iii. pre-deprivation hearing was required

This Court has expressly held that procedural due process requires a pre-deprivation hearing unless specific requirements are met. *See, Lemon v. Mississippi Transp. Comm'n,* 735 So.2d 1013, 1020-21 (Miss. 1999). Specifically:

> Three conditions must be met before a post-deprivation remedy will be deemed to satisfy due process. "The conditions are, first, that the deprivation be unpredictable; second, that predeprivation process be impossible, making any additional safeguard useless; and, third, that the conduct of the state actor be unauthorized." *Charbonnet v. Lee,* 951 F.2d 638, 642 (5th Cir.1992) (footnote omitted). . . .
>
> Finally, the United States Supreme Court has stated that "[i]n situations where the State feasibly can provide a predeprivation hearing before taking property, it generally must do so regardless of the adequacy of a postdeprivation ... remedy to compensate for the taking." *Zinermon v. Burch,* 494 U.S. 113, 132, 110 S.Ct. 975, 987, 108 L.Ed.2d 100, 118 (1990).

Id. (emphasis added).

The MTC identifies the "process" afforded a "taxpayer" in the circumstances of an assessment as follows:

> Q: Okay. So your testimony is the first step in the due process was the letter that was attempted to sent – that the Commission attempted to send to the –
>
> A: Correct.
>
> Q: --taxpayer prior to the audit?
>
> A: Correct. And then ***the next step would be, once the assessment is made, the taxpayer has 10 days in which to review and appeal their assessment.*** If they agree with it, they're able to pay the demand notice that comes out.
>
> ***If they choose to appeal it, then they have an option to come to an administrative appeal,*** which this taxpayer did. That administrative appeal is a fairly informal board.
>
> It consists of people who are knowledgeable of the sales tax law and very aware of – of the nuances that exist with any particular industry. ***And then following there is another ten-day period that the taxpayer is given to appeal that decision of the review board to another level within the agency.*** And this taxpayer did not choose to make himself useful in that – that area.
>
> Q: ***And it was not until all of that had been expired that F&G was notified*** in November of 2001 was the – was the letter.
>
> A: ***November 8, 2001. And the review board – September 21 was the date that we learned that no full Commission hearing had been requested.***

(Rec02. 119-120)

The MTC freely admits that Sureties are not notified nor allowed to participate in any pre-deprivation hearing to contest an assessment. Indeed, the MTC makes no effort whatsoever to notify the Surety until ***all*** "due process" afforded has already been exhausted by the Principal. (Rec. Ex Tab 5) As a matter of policy and practice, Sureties are ***never*** afforded the opportunity to be heard at any time, much less "at a meaningful time and in a meaningful manner."

A meaningful time would have been, at a minimum, before expiration of the time allowed for a review hearing. A meaningful manner would allow the Surety to examine the auditor and the records upon which the auditor based his assessment. By the time the MTC gets around to letting the Surety know of the assessment, the Principal is, as in these cases, out of business, the auditor cannot be produced by the Commission and there are no underlying documents to substantiate the auditor's notes in the file.

The record and law are very clear. The Sureties were entitled to the protections afforded by the constitutional guaranty of due process and did not receive these protections. The lower courts erred in failing to address and rectify this denial.

B. The Sureties Cannot be held Liable for Penalties and Interest Attributable to the Principals' Alleged Failure to Pay Taxes.

1. Surety is only liable for interest that accrues after demand.

Under Mississippi law a surety can only be held liable for interest that accrues as a result of ***its own failure to pay***. *State v. Moody*, 198 So. 2d 586, 591-92 (Miss. 1967). In *Moody*, a member of the Pearl River County Board of Supervisors was found to have unlawfully converted county funds to his own use. *Id.* at 587-88. The trial court held that the absconding supervisor was liable for the full amount unlawfully appropriated plus interest accruing from the date of each misappropriation. *Id.* The trial court only held the sureties on the supervisor's public official's bond liable for interest ***accruing from the date of demand on the bond***. *Id.* at 587.

In affirming the trial court's ruling that the surety can ***only*** be held liable for interest accruing after the date of demand, this Court looked to case authority decided in other states. *Id.* at 591-92. This Court cited the following language from *In re Perelstine*, 44 F.2d 62, 64 (W.D. Pa. 1930) as persuasive in adopting the same rule of law in Mississippi:

> We come next to the charge of interest against Frederick. Is the surety liable for that? There is no doubt about Frederick's liability to pay interest, but ***a surety company is chargeable with interest only when it has failed to make good after the defalcation has been called to its attention***. . . .

Id. at 591 (emphasis added). Additionally, this Court cited the following language from *Cunningham v. Cunningham*, 157 F.2d 859, 861 (1946):

> ***Nothing is due from the surety until he is notified of his principal's delinquency***; if he then unjustly withholds payment, he is liable for interest because of his unjustifiable detention of the money. ***He is not required to take the initiative*** in making payment, and stands only as security until a claimant makes actual demand; ***then only does interest begin to accrue***.

Id. at 592 (emphasis added).

Importantly, the MTC admits that ***all*** of the interest demanded and/or paid under protest by the Sureties accrued ***prior to*** the Commission making demand upon the bonds. (Rec02. 54) (Rec. Ex. Tab 5) Accordingly, the MTC could not legally require the Sureties to pay interest, which accrued prior to making demand. The trial courts erred in failing to find for the Sureties on this issue.

2. The Sureties cannot be penalized for the Principals' failure to pay taxes.

The Mississippi Supreme Court has long recognized that statutory penalties are to be "narrowly" and "strictly" construed. *Midsouth Rail Corp. v. Citizens Bank & Trust Co., Inc.*, 697 So.2d 451, 458 (Miss.1997)("[i]t is a general rule of statutory construction that penal statutes are to be strictly construed.")(citing *Mississippi Insurance Commission v. Savery,* 204 So.2d 278 (Miss.1967)). Further, "[p]enalties ***are not to be imposed by implication***. They ***must be*** provide [sic] for in plain language." *Winter v. Hardester,* 98 So.2d 629, 631 (Miss.1957). *See also,*

Attala Loans, Inc. v. Standard Discount Corp., 161 So.2d 631, 638 (Miss.1964)("[p]enal statutes are not to be extended in their operation to persons, things, or acts not within their descriptive terms, or the fair and clear import of the language used.").

The statutory authority for assessing a penalty for non-payment of sales tax is found at Miss. Code Ann. § 27-65-39 which sets forth the following:

> ***If*** any part of the ***deficient or delinquent tax is due to negligence or failure to comply with the provisions of this chapter*** or authorized rules and regulations promulgated under the provision of this chapter without intent to defraud, there ***may*** be added as damages ***ten percent for the first offense, fifteen percent for the second offense, twenty-five percent for the third offense, and fifty percent for any subsequent offense*** of the total amount of deficiency or delinquency in the tax, or interest at the rate of one percent per month, or both, from the date such tax was due until paid, and said tax, damages and interest shall become payable upon notice and demand by the commissioner.

Miss. Code Ann. § 27-65-39 (emphasis added). Clearly, the penalty is ***only*** authorized upon a finding of fault and is progressively higher with repeated violations on the part of any particular taxpayer.

This Court has long recognized that the legislative purpose in providing for the Commission's power to exact penalties from taxpayers who fail to follow the tax code is "to induce prompt payment of taxes . . ." *Broadhead v. Monaghan*, 117 So. 2d 881, 888 (Miss. 1960); *Boyd v. Coleman*, 111 So. 600, 604 (Miss. 1927)("[t]he penalty . . . prescribed by the act for failure to promptly comply with the provisions thereof was undoubtedly intended to secure prompt compliance with the provisions of the act . . ."). This Court has also acknowledged that "[p]enalties are graduated in severity according to the evils which the lawmaker wishes to prevent and the exigencies with which the penalty imposing statute deals . . ." *Broadhead*, 117 So. 2d at 889. Furthermore, in *Boyd*, this Court specifically recognized that when the state renders compliance impossible, it cannot exact a penalty. *Boyd*, 111 So. at 604-05.

The Aaim case is illustrative. The MTC required F&G to pay penalties for Aaim's ***third*** offense of negligently failing to pay taxes when due. Indeed, the MTC admits that the amount of the penalty at issue was a direct result of Aaim's negligence. The following exchange, in pertinent part, occurred in the MTC's Rule 30(b)(6) deposition:

> Q: . . . I just want to go over with you generally -- this particular assessment wasn't the first time AAIM had had an issue.
>
> A: My understanding is that this was the fourth audit of AAIM Construction – or AAIM – yeah. AAIM Construction.
>
> . . .
>
> Q: Well, just – back to my question. The – the fact that there were – well, ***you would agree with me, won't you, that 25 percent penalty was charged?***
>
> A: ***I do agree with that.***
>
> Q: Okay.
>
> A: ***And that's an accelerated rate.***
>
> Q: ***Right. And the reason for that accelerated rate was because there were assessments in the last two audits; is that correct? Or have I misunderstood?***
>
> A: ***Yeah. Yeah. I mean negligence was found in each of those prior times.*** And when negligence is determined, there was an accelerated rate of penalty applied in – in those prior audits.
>
> Q: So this accelerated rate is a punishment basically for not correcting the mistakes of the past?
>
> A: Well, 27-65-39 basically says that, you know, once – once you failed to file – pay your taxes properly – on the first offense, if it's determined to be negligence, you are assessed a 10 percent penalty. On the second offense, you're assessed a 15. And on the third offense, 25. And on the fourth, a 50 percent.
>
> So the law required the accelerated penalty based on the fact that negligence was determined during the audit.
>
> Q: Let me make sure I understand this then. If, for example – and you used this example – AAIM had gotten some bad information from the Tax Commission in '94, and that was the reason for underpayment of $16,000. Would a penalty have been assessed in that situation?

A: That is – that is a hypothetical situation. But if – if it can reasonably be ascertained that have gotten bad information form this agency, then that's not going to be negligence, and a penalty would not be appropriate.

Q: Okay. ***So who makes the determination whether there was negligence or not?***

A: Well, ***the auditor*** would be the first set of eyes making the determination. And then the ***review board*** would be – assuming that the taxpayer appeals it, the review board would come into the picture during an appeal.

If the auditor is questioning whether or not it's negligence, they're going to meet with their manager and discuss it with their manager.

Q: Okay. ***So just because there is an assessment doesn't mean a penalty follows, if I'm understanding you correctly?***

A: ***That is correct. A penalty is applied when there is negligence by the taxpayer.***

(Rec02. 118-119)

Clearly, a penalty is not mandatory for every assessment as section 27-65-39 provides that the penalty "***may*** be added" not "***shall*** be added." There was no dispute in any of the cases consolidated in this appeal that the penalties assessed were on the basis of ***the Principals'*** alleged repeated negligence and failure to comply with the sales tax requirement, not because of any such negligence and/or failure on the part of the Sureties. (TR2 36) (Rec02. 54, 118-119) It is MTC's position that Sureties ***could not*** be given any notice whatsoever and, therefore, ***could not*** have promptly paid the taxes until after penalties were assessed and demanded.

In short, the Sureties committed no "evil" for which punishment in the form of a penalty was warranted. Under Mississippi law, the Sureties cannot be required to pay a penalty for the Principal's negligence.

C. Confidentiality Statutes Did Not Prevent the MTC From Affording Due Process to the Sureties

In the proceedings below, the trial courts accepted the MTC's argument that it could not provide the Sureties with the notice required by due process because the Principal's confidentiality was not waived until the MTC chose to make a claim. This argument, raised late in the Aaim proceeding, directly contracts the MTC's Rule 30(b)(6) testimony and inevitably requires an unconstitutional interpretation of Miss. Code Ann. §§ 27-3-73 and 27-65-81.

1. The argument is a pre-text and is inconsistent with Rule 30(b)(6) testimony.

In the Aaim case, F&G took the Rule 30(b)(6) deposition of the MTC. The following exchange occurred:

Q: Okay. Was there anything prohibiting or limiting the Tax Commission from sending a copy of this letter to the bond company?

> A: There would be no reason to send it to a bond company at the onset of an audit, we don't know whether there will be any liability. At the onset of the audit we don't know which – if there are any bonding companies that would potentially have a liability. So there is no reason to send this letter at the onset of an audit.
>
> Q: Okay. My question is , is there anything that would prohibit –
>
> A: I don't think there is statutorily anything that would prohibit that.
>
> . . .
>
> Q: This is, I'm assuming, the official assessment letter –
>
> A: That's correct.
>
> Q: -- to the taxpayer. This would have been drafted after the actual audit?
>
> A: Upon completion of the audit. That is correct.
>
> Q: And then the taxpayer is sent written notification, and I see a certified mail receipt – a copy of that. It appears to be overlapping the letter.
>
> A: Yes.
>
> Q: Was a copy of this sent to F&G?

A: No

Q: Okay. Was there – is there any statutory reason why – that would prohibit the Commission from sending F&G a copy of –

A: I do not know of any –

. . .

Q: Is there ***any*** reason that you can think of that would prohibit the State Tax Commission from sending a copy of this to F&G?

A: ***I know of no reason.***

(Rec02. 82)

When asked the questions on July 28, 2003 in its Rule 30(b)(6) deposition, the MTC could not identify any statutory prohibition to providing notice to the surety of an audit, the result of an audit and no reason that would have prevented the MTC from sending the Surety a copy of any notice setting a hearing to contest any assessment arising from an audit. (Rec02. 82, 90) The confidentiality argument relied upon MTC in the proceedings below was certainly not identified. Indeed, this argument was not raised until later in the Aaim proceeding. (Rec02. 475-477) This argument is clearly nothing more than MTC's after-thought justification for its policies which clearly violated the constitutional rights of the Sureties in this case.

2. The trial courts' decisions require an unconstitutional statutory interpretation.

Mississippi law requires the existence of a tax bond in favor of the State of Mississippi. *See* Miss. Code Ann. § 27-65-21 Accordingly, by operation and under color of law, the State of Mississippi may require payment from the bonding company for taxes assessed against the principal to the bond who cannot or will not pay. Clearly, ***anytime*** an assessment is demanded of a principal, the surety is at risk and its interests are effected. Indeed, the MTC claims that the surety has the same liability as the principal. (Rec02. 120) Under the interpretation of Miss. Code Ann. §§ 27-3-73 and 27-65-81 advocated by the MTC, it was absolutely prohibited from

giving the Sureties any notice whatsoever regarding the audits and assessments against the Principals and any hearing that occurred prior to demands on the Riders. The MTC advocated this position in spite of the fact that Miss. Code Ann.§ 27-65-21 requires the tax bond making the surety equally liable for any taxes assessed. In short, under the MTC's interpretation, one statute requires the existence of a bond and, therefore, a surety whose interests may be adversely affected any time there is an assessment and/or a hearing regarding an assessment, thus, invoking the right to due process. While, on the other hand, two different statutes prohibit giving the very notice required by due process. If the MTC is correct, then Miss. Code Ann. §§ 27-3-73 and 27-65-81 are unconstitutional under the Fifth and Fourteenth Amendments to the United States Constitution. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950).

It has long been the law in Mississippi that:

> If a statute is susceptible of two constructions, one of which will render it constitutional and the other of which will render it unconstitutional in whole or in part, or raise grave and doubtful constitutional questions, the court ***will*** adopt ***that construction which***, without doing violence to fair meaning of language, ***will render it valid***, in its entirety, or free it from doubt as to its constitutionality, even though the other construction is equally reasonable, or seems the more obvious, natural, and preferable, interpretation.

Craig v. Mills, 33 So. 2d 801, 804 (Miss. 1948)(emphasis added).

Neither Miss. Code Ann. §§ 27-3-73 nor 27-65-81 prevented the MTC from giving notice to the sureties that an audit would be conducted, that an assessment had been made or that a hear would or could be held to contest any such assessment. Indeed, a close examination of section 27-3-73 reveals that it is completely inapplicable to the present actions as this provision only "relates to all taxes ***collected*** by the Mississippi State Tax Commission ***and not referred to*** in Sections 27-7-83, 27-13-57 and ***27-65-81*** . . ." See Miss. Code Ann. § 27-3-73 (emphasis added). As the taxes at issue were all assessed pursuant to chapter 65 of the tax code and those taxes had not been collected as of the relevant time period, section 27-3-73 clearly cannot form

the basis of the MTC's argument. Accordingly, the only relevant provision to this discussion is Miss. Code Ann.§ 27-65-81.

Section 27-65-81(1) sets forth the confidentiality requirement relied upon by the MTC. This provision provides:

> (1) Applications, returns and information contained therein filed or furnished under this chapter shall be confidential, and except in accordance with proper judicial order or as otherwise authorized by this section, it shall be unlawful for members of the State Tax Commission or members of the Central Data Processing Authority, any deputy, agent, clerk or other officer or employee thereof, or any former employee thereof to divulge or make known in any manner the amount of income or any particulars set forth or disclosed on any application, report or return required.
>
> The term "proper judicial order" as used in this section shall not include subpoenas or subpoenas duces tecum but shall include only those orders entered by a court of record in this state after furnishing notice and a hearing to the taxpayer and the State Tax Commission. The court shall not authorize the furnishing of such information unless it is satisfied that the information is needed to pursue pending litigation wherein the return itself is in issue, or the judge is satisfied that the need for furnishing the information outweighs the rights of the taxpayer to have such information secreted.

Miss. Code Ann. § 27-65-81(1). This provision does not speak to whether the identified information is confidential even as to the taxpayer. On its face, the provision could be interpreted to require the Commission to keep the identified information confidential even from the taxpayer. Such an interpretation would be illogical. In the case of an assessment, how could a taxpayer pay the assessment without knowing the very information that is supposed to be "confidential?" Clearly, this provision cannot be interpreted as prohibiting the release of confidential information to the taxpayer who may or will be called upon to pay.

As discussed in greater detail below, the Sureties are "taxpayers" with regard to the assessments at issue in this case. The statutory definition of "taxpayer" set forth in Miss. Code Ann.§ 27-65-3 is "any person ***liable for or having paid any tax*** to the State of Mississippi under the provisions of this chapter." Miss. Code Ann.§ 27-65-3(e). Accordingly, Miss. Code Ann.§

27-65-81 can legitimately be interpreted as excluding any "taxpayer" as defined by that section from the confidentiality provisions. This interpretation preserves the constitutionality of the statute by allowing for proper notice and hearing to ***any*** "taxpayer" who may be called upon to pay an assessment while at the same time, preserving confidentiality as to third-parties with no immediate or pendant liability. This interpretation does not do violence to the meaning of the statute nor does it render the statute unconstitutional. Accordingly, this is the interpretation that should have been adopted by the lower courts. *Craig v. Mills*, 33 So. 2d 801, 804 (Miss. 1948).

Finally, the MTC's confidentiality argument disregards the waiver of confidentiality included in the Riders, discussed in greater detail below. Clearly, MTC's decision to include a waiver in the Rider it drafted reveals confidentiality to be an inadequate reason to deny due process to the Sureties. It is an argument that should be rejected by this Court.

II. THE COURT BELOW ERRED IN FINDING THAT THE SURETIES LACKED STANDING.

The requirements of standing are well established. The concept of standing includes three elements: (1) the plaintiff has suffered a "concrete and particularized" injury that is "actual and concrete"; (2) there is "a causal connection between the injury and the conduct complained of . . . 'fairly ... trace[able] to the challenged action of the defendant, and not ... th[e] result [of] the independent action of some third party not before the court'" and (3) a likelihood that the injury will be "redressed by a favorable decision." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992).

The MTC's standing argument in the proceedings below did not challenge or even address the elements of standing outlined above. Rather, the decision turned on the trial courts' acceptance of argument that F&G is not a "taxpayer" entitled to due process. This decision is in error and should be rejected by this Court.

Miss. Code Ann. § 27-65-3 defines "taxpayer" as "any person ***liable for or having paid any tax*** to the State of Mississippi under the provisions of this chapter." Miss. Code Ann.§ 27-65-3(e)(emphasis added). Further, the code includes "corporations" and "firms" in its definition of "person." Miss. Code Ann.§ 27-65-3(c).

Clearly, the Sureties, as corporations, each constitute a "person" as defined by the statute. Equally clear are the Sureties' status as "taxpayers" as defined by the statute. It is undisputed that the Commission considered the Sureties equally liable with the Principals for payment of the assessment at issue in the present case. (Rec02. 120) Further, the Sureties did, in many instances, ***actually pay*** the taxes, penalties and/or interest assessed against the Principals and demanded by the MTC.

There can be no doubt that the Sureties are "taxpayers" under the relevant definitions included in Miss. Code Ann. § 27-65-3. The Court need not look any further than the plain meaning and intent of the very statute (Mississippi Code Annotated Section 27-65-3) referenced by the MTC in support of its lack of standing argument. As a result of issuing the sales tax bonds required by Mississippi Code Annotated Section 27-65-21, the Sureties have either paid or are liable for paying taxes at issue in this action to the State of Mississippi under chapter 65 of title 27 of the Mississippi Code.

In the proceedings below, the MTC tried to draw a distinction between the obligations pursuant to the various tax bonds/riders ***to pay taxes*** to the State of Mississippi on behalf of the Principals and the ***payment of a debt*** of the Principals pursuant to a contract. Specifically, the MTC argued that the Sureties were "not making a tax payment, they're paying a debt they contracted for." (TR2 17) This argument makes no sense, particularly in light of the fact that the contracts expressly reference the "taxes" of the Principals not the "debts." (Rec. Ex. Tab 5) Whether the Principals pay the tax liabilities directly or the Sureties pay these taxes pursuant to

the Riders, the payment of taxes is still the payment of taxes. The distinction advocated by MTC ***does not change the fact that the Sureties have paid or are liable for paying taxes to the State of Mississippi.*** Therefore, straightforward statutory interpretation results in a finding that the Sureties are taxpayers within the meaning of the sales tax statutes.

While there is no case on point in Mississippi, our sister jurisdiction of Tennessee has addressed this very issue. In *Exchange Mutual Insurance Company v. Olsen*, 667 S.W.2d 62, 63 (Tenn. 1984), the Tennessee Supreme Court stated the following:

> It is well settled in Tennessee that ***a surety stands in the shoes of the principal.*** *In Re Estate of Darwin,* 503 S.W.2d 511, (Tenn.1973); *City of Nashville v. Singer & Johnson Fertilizer Co.,* 127 Tenn. 107, 153 S.W. 838 (1913).
>
> . . .
>
> ***Both the principal and surety under this bond shall be considered the taxpayers as to the State of Tennessee with all rights, privileges, obligations and limitations pertaining to taxpayers under the laws of the State of Tennessee.***
>
> "This being true, ***a privilege tax to the principal is also a privilege tax to the surety.***" In Re Estate of Darwin, supra, at 513. Following this analysis in the Darwin case, this Court concluded ***that a surety who had issued a bond*** to the Commissioner of Revenue **to cover taxes** incurred from the wholesaling of beer, ale, and other malt beverages, ***was liable to the State for a tax rather than for a debt arising under contract.*** Although the statute involved in Darwin, T.C.A. § 57-6-107, covered taxes from the wholesale of malt beverages, the analysis is applicable to the case at bar and T.C.A. § 57-4-302 which covers the tax on retail sales of alcoholic beverages. Accordingly, Exchange Mutual's argument that this case should be decided on contract principles is without merit. ***The State has a claim for a tax and not for a debt owed on a contract.***

Exchange Mutual Insurance Company v. Olsen, 667 S.W.2d 62, 63 (Tenn. 1984)(emphasis added).

Like Tennessee, it is well settled in Mississippi that a surety stands in the shoes of the principal.[7] And while the case above involves a tax bond for sales taxes relating to alcoholic

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[7] *See Cooper Industries, Inc. v. Tarmac Roofing Systems, Inc.*, 276 F.3d 704 (5th Cir. (Miss.) 2002) (Under Mississippi law, roofing contractor's surety by taking over contract upon

beverages, the very same analysis applies to the instant consolidated cases. In other words, when the Principals failed to pay the State of Mississippi for sales taxes, the Sureties stepped into their shoes, and for purposes of standing, the Sureties under the various Riders ***are*** the taxpayers in relation to the State of Mississippi with all rights, privileges, obligations and limitations pertaining to taxpayers under the laws of the State of Mississippi. In addition, and consistent with the Tennessee court's holding above, the Sureties were liable to the State of Mississippi for a ***tax not a debt arising under contract.***

The MTC should not be allowed to have it both ways. One the one hand, the MTC takes the position that the Sureties are not taxpayers for the purposes of standing while on the other hand holding them liable for the penalties and interest assessed as a direct result of the alleged failure to pay taxes of the Principals. The court below erred in accepting this argument.

III. IN THE ALTERNATIVE, THE COURTS BELOW ERRED IN THE APPLICATION OF CONTRACT LAW.

A. The Language of the Riders Must be Construed Against the Commission.

In the proceedings below, the MTC argued that the language of the Riders at issue required the Sureties to "make the State of Mississippi whole" by paying not only the tax assessed to the Principals but also the penalties assessed against the Principals for the alleged offense of negligent failure to properly pay sales tax and for interest accrued prior to the Sureties' notification of the assessments. (Rec02. 484-485) In support of this argument, the MTC relied upon *Mississippi Farm Bureau Casualty Co. v. Britt*, 826 So. 2d 1261 (Miss. 2002) for the proposition that courts must give contract terms their plain and ordinary meaning and enforce

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contractor's default stepped into contractor's shoes and assumed contractor's duty.); *Hanberry Corp. v. State Bldg. Commission*, 390 So.2d 277 (Miss. 1980) (Since surety guaranteed that mechanical contractor would perform its duties under its contract, including duty of coordinating its operations with those of other "co-prime" contractors, the surety, which took over when the mechanical contractor defaulted, stepped into shoes of the latter.).

provisions as written as set forth below, the language used in the Riders is neither clear nor unambiguous. However, the language at issue in the Riders, unlike the language at issue in *Britt*, is ***not*** clear and unambiguous. Further, as the MTC provided the language, any ambiguity must be construed against it.

1. The language is ambiguous.

The language relied upon by the MTC in the proceedings below is as follows:

> WHEREAS, under the provisions of ***Section 27-65-21***, Mississippi Code of 1072, as amended, the said ***Principal is required*** to an has furnished the ***attached*** bond guaranteeing payment of all taxes, damages, interest, and penalties which may accrue to the State of Mississippi under Section 27-65-1 et seq., and Section 27-67-1 et seq., and Section 27-7-1 et seq., and Section 27-13-1 et seq., and Section 27-7-301 et seq., and Section 27-55-313, Mississippi Code of 1972, and amendments thereto, on account of entering into said contract.
>
> NOW, THEREFORE, in addition to the obligations set forth in the attached bond, there is hereby imposed the additional obligations set forth in the attached bond, there is hereby imposed the additional obligation by this Rider that ***the Contractor*** shall promptly make payment when due of all taxes, damages, interest and penalties which may accrue to the State of Mississippi . . .

(Rec02. 484) Contrary to the Commission's position and the lower courts' findings, this language is far from "clear and unambiguous."

First, the initial clause set forth above states that Miss. Code Ann. § 27-65-21 ***requires*** that the "Principal," furnish a bond "guaranteeing payment of all taxes, damages, interest, and penalties which may accrue to the State of Mississippi." However, Section 27-65-21 ***only*** requires a bond covering "taxes," not "damages, interest and penalties." *See* Miss. Code Ann. § 27-65-21. Accordingly, there is a direct conflict in the meaning of this clause caused by language implying a statutory requirement that simply does not exist. Additionally, this clause refers to an "***attached bond*** guaranteeing payment of all taxes, damages, interest, and penalties which may accrue to the State of Mississippi." The only bonds related to the Riders are payment

and/or performance bonds that, in no way, reference the payment of taxes, damages, interest and penalties to the State of Mississippi. (Rec02. 342-384)

In the second clause referenced above, the language utilized states that the "Contractor" is obligated to pay "all taxes, damages, interest, and penalties which may accrue to the State of Mississippi." The "Contractor" refers to the Principals as identified in the payment and performance bonds to which the Riders were attached. (Rec02. 342-384) (Rec. Ex. Tab 5) The Riders include ***no language*** whatsoever imposing a duty on the Sureties for the payment of interest and penalties assessed against the Principals and certainly do not contain any language constituting a waiver of the constitutional right to due process prior to being held liable for any assessment.

Despite protestations to the contrary, the language relied upon by the MTC is, in fact, ambiguous. Perhaps understanding that the language of the Riders arguably does not, on its face, obligate the Sureties to pay ***any amount whatsoever***, the MTC argued in the proceedings below that the "intent" of the Riders "was to make the State of Mississippi whole."

In support of this argument, the MTC cited *Stowell v. Clark*, 118 So. 370, 372 (Miss. 1928). This reliance was misplaced. *Stowell* involved the terms of a construction payment bond that ***expressly*** provided for the payment of attorney fees incurred by a legitimate claimant in enforcing a claim against the bond. *Stowell*, 118 So. at 372. Unlike the terms of the present Riders, the terms of the payment bond at issue in *Stovall* clearly provided for the payment of attorney fees. *Id.* The MTC argued that the *Stovall* case also turned on the implicit "intent" of a payment bond to make claimants whole. This is clearly not the law in Mississippi as set forth in *Sentinel Industrial Contracting Corp. v. Kimmins Industrial Service Corp.*, 743 So. 2d 954, 971 (Miss. 1999) wherein the Mississippi Supreme Court clearly recognized that "[i]t is well

settled, however, that a claimant on a contract surety bond, such as here involved, is not entitled to recover attorney's fees unless a statute or the contract with the surety so requires."

The MTC's "made-whole" argument is also undermined by the language of the statute which mandates the very existence of the Riders and is specifically referenced therein. Miss. Code Ann. § 27-65-21 sets forth, in pertinent part:

> Any person entering into any contract over Seventy-five Thousand Dollars ($75,000.00) as defined in this section shall, before beginning the performance of such contract or contracts, either pay the contractors' tax in advance, together with any use taxes due under Section 27-67-5, ***or execute and file with the Chairman of the State Tax Commission a good and valid bond in a surety company authorized to do business in this state, or with sufficient sureties to be approved by the commissioner conditioned that all taxes which may accrue to the State of Mississippi*** under this chapter, or under Section 27-67-5 and Section 27-7-5, will be paid when due.

Miss. Code Ann. § 27-65-21 (emphasis added). The statute ***only*** requires a bond to cover ***taxes*** that accrue to the State of Mississippi, not interest accrued without notice to the surety and certainly not penalties charged as a result of repeated negligence by the Contractor.[8] As the Riders at issue are mandated by statute, any intent inferred into the Riders should, accordingly, be derived from that statute. Clearly, the statute provides that the purpose of the bond requirement is to cover ***taxes*** payable, not penalties and interest accrued against the Contractor.

Additionally, the MTC argued that the following language included in the Riders is clear and unambiguous and prevented it from providing any form of notice to the Sureties:

> NOTWITHSTANDING the tax information and return confidentiality provisions contained within Sections 27-65-1 et seq., 27-67-1 et seq., 27-7-1 et seq., 27-13-1 et seq., and 27-55-301 et seq., Mississippi Code 1972, and amendments thereto, principal hereby authorizes the State Tax Commission to release to surety any information relating to ***any claim*** against said surety made by the State Tax Commission which is covered by this bond.

[8] The Commission apparently agrees as it cited this statute for the proposition that the Riders were required by law. (Rec02. 486)

The MTC took the position that this ***waiver*** of confidentiality is ***only*** applicable once demand is actually made against the surety. (Rec02. 488) Further, the Commission argued that providing the Sureties with the notice required by due process would constitute a violation of Miss. Code Ann. §§ 27-3-73 and 27-65-81. As addressed above, the MTC's argument is clearly without merit.

First, simply giving notice to a surety of an audit, that an assessment had been made and/or that a hearing would be conducted, would not violate the confidentiality provisions of sections 27-3-73[9] or 27-65-81. Specifically, section 27-3-73 only requires that the Commission keep confidential "the ***amount of income*** or ***any particulars*** set forth or disclosed in any report or return required on any taxes collected by reports received by the State Tax Commission . . ." Miss Code Ann § 27-3-73 (emphasis added). Likewise, section 27-65-81 ***only*** prohibits the disclosure of "the ***amount of income*** or ***any particulars set forth or disclosed on any application, report or return*** . . ." Miss. Code Ann. § 27-65-81 (emphasis added). Simple notice that an audit was being conducted, that an assessment had been made and that a hearing would be conducted would not, in any way, require the MTC or its employees to violate the requirements of these statutes.

Second, the MTC views the liability of the Sureties to be equal to that of the Principals. (Rec02. 120) Certainly it is the Commission's position that the Sureties were in privity with the Principals with regard to the assessments at issue in this action. Accordingly, under the Commission's position ***any claim*** against the Principal is also a ***claim***, or at the very least, a potential claim against the Surety.

[9] As set forth *supra*, Miss. Code Ann. § 27-3-73 is completely irrelevant to this case.

Third, the language utilized was solely in the control of the MTC. Indeed, the Riders upon which the MTC based its demand against the Sureties were each issued on ***State Tax Commission's own Form 61-001 (Rev. 11/91)***. (Rec02. 339-340)(Rec. Ex. Tab 5) F&G did ***not*** draft the language in the Riders, nor did ***it have the authority to alter and/or amend the language included in the Riders***. (Rec02. 339-340) (Rec. Ex. Tab 5) It is unconscionable to allow the MTC to evade the requirements of due process by wording its ability to comply with those requirements out of contract provisions over which it, alone, has control.

b. Ambiguous language is construed against the drafter.

It has long been the law in Mississippi that any ambiguity in the terms of a contract are construed most strongly against the drafter. *Royer Homes of Mississippi, Inc. v. Chandeleur Homes, Inc.*, 857 So. 2d 748, 759 (Miss. 2003)("where a contract is doubtful or ambiguous, any ambiguity can be construed against the drafter."); *Wade v. Selby*, 722 So. 2d 698, 701 (Miss. 1998); *Wallace v. United Mississippi Bank*, 726 So. 2d 578, 588 (Miss. 1998)("[w]ritten instruments are to be construed narrowly against the drafter when there is uncertainty or ambiguity as to the intent of the parties."); *Estate of Parker v. Dorchak*, 673 So. 2d 1379, 1382 (Miss. 1996); *Banks v. Banks*, 648 So. 2d 1116, 1121 (Miss. 1994) ("When the terms of a contract are vague or ambiguous, they are always construed more strongly against the party preparing it."). *See also, Clark v. Carter*, 351 So. 2d 1333, 1336 (Miss. 1977); *Stampley v. Gilbert*, 332 So. 2d 61, 63 (Miss. 1976). This is especially so when a party to the contract has no input into the terms. *Merchants Nat. Bank v. Stewart*, 608 So. 2d 1120, 1126 (Miss. 1992)("[t]he rationale for construing mortgages narrowly against the mortgagee is that the lender normally dictates the terms and conditions of its loans and the borrower has no choice other than accepting these terms and conditions.").

As set forth above, the Riders upon which the MTC based its demand against the Sureties were each issued on ***State Tax Commission's own Form 61-001 (Rev. 11/91)***. (Rec02. 339-340)(Rec. Ex. Tab 5) The Sureties did ***not*** draft the language in the Riders, nor did ***they have the authority to alter and/or amend the language included in the Riders***.

Inasmuch as ***the Riders at issue herein are issued on the Commission's own form***, the MTC is clearly the "drafter" of the ambiguous language included in these Riders. Accordingly, the ambiguous language included in the Riders ***must*** be construed against the MTC.

2. Mississippi Law Must Be Read Into the Riders.

Mississippi law "'in force at the time that a contract is made forms a part of it and is written into the contract as much as if expressly incorporated therein.'" *Ivison v. Ivison*, 762 So.2d 329, 335 (Miss. 2000)(citing *Mississippi Valley Gas Co. v. Boydstun*, 230 Miss. 11, 31, 92 So.2d 334, 340 (1957)). Under established Mississippi law, the Sureties are not responsible for the payment of a penalty incurred due to the Principals' negligence nor are they responsible for interest accrued prior to the MTC's demands on the Riders.

In the proceedings below, the MTC argued, based solely on a general discussion of the relationship a surety and principal included in a legal encyclopedia, that it has not, in fact, shifted the penalty of the Principal's negligence to the Sureties because the Sureties had a contractual right to reimbursement from the Principals. (Rec02. 487) This argument must fail for two reasons. First, the right to reimbursement from the Principals is, at best, illusory given that the Principals could not pay the assessments in the first instance and are now out of business. (Rec02. 171, 179-180) Second, this argument is directly contradictory to Mississippi law.

The Mississippi Supreme Court has long recognized that statutory penalties are to be "narrowly" and "strictly" construed. *Midsouth Rail Corp. v. Citizens Bank & Trust Co., Inc.*, 697 So.2d 451, 458 (Miss.1997)("[i]t is a general rule of statutory construction that penal statutes

are to be strictly construed.")(citing *Mississippi Insurance Commission v. Savery,* 204 So.2d 278 (Miss.1967)). Further, it has long been the law in Mississippi that "[p]enalties ***are not to be imposed by implication.*** They ***must be*** provide [sic] for in plain language." *Winter v. Hardester,* 98 So.2d 629, 631 (Miss.1957). *See also, Attala Loans, Inc. v. Standard Discount Corp.*, 161 So.2d 631, 638 (Miss.1964)("[p]enal statutes are not to be extended in their operation to persons, things, or acts not within their descriptive terms, or the fair and clear import of the language used.").

The statutory authority for assessing a penalty for non-payment of sales tax is found at Miss. Code Ann. § 27-65-39. The penalty provided for in this statute is ***only*** authorized upon a finding of fault and is progressively higher with repeated violations. Miss. Code Ann. § 27-65-39 (emphasis added). Nowhere in the statute is it even insinuated that the MTC has the authority to collect a penalty from an individual or entity that has ***not*** been negligent with regard to payment of a tax or an assessment. On the contrary, ***it has been the law in Mississippi for more than a century that a penalty imposed by law cannot be recovered from a surety absent express statutory authority.*** *See H.S. Foote v. Edmund Vanzandt*, 34 Miss. 40 (Miss. 1857). The Sureties are not aware of any statute that gives the MTC authority to exact from a surety the penalty charged against the Principal as punishment for its repeated negligence.[10]

Likewise, it has long been the law in Mississippi that a surety is ***only*** obligated to pay for interest assessed ***after*** it is notified of a claim on the bond. *See, State v. Moody*, 198 So. 2d 586, 591-92 (Miss. 1967). This law is, likewise, written into the language of the Riders. In *Moody*, the Mississippi Supreme Court held that "***a surety company is chargeable with interest only***

[10] It is undisputed that the penalties at issue in this case were charged against the Principals as a result of the MTC's findings that the Principals had been negligent in the payment of sales tax. (Rec02. 118-119)

when it has failed to make good after the defalcation has been called to its attention. . . . *See*, *State v. Moody*, 198 So. 2d 586, 591 (Miss. 1967)(emphasis added).

The above-cited law prohibiting the impositions of a penalty on one for the wrong-doing of another[11] was thoroughly established prior to 1998 and 1999 when the first Riders at issue in this case issued. (Rec. Ex. Tab 5) Accordingly, the language relied upon by the Commission ***must*** be read in light of this law. As such, the "penalties" referenced in the language of the Bonds can ***only*** be collected from the surety if directly authorized by Miss. Code Ann. § 27-65-39 and "interest" can ***only*** be collected for that amount interest accrued after notice to the surety. Any other interpretation fails to incorporate relevant Mississippi law into the terms of the Bonds.

[11] Indeed, good public policy would seem to mandate a prohibition on the ability to shift the risk of penalty for breaking the law to an insurer.

CONCLUSION

Fairness is at the heart of the concept of due process. Fairness is also the underlying concept in the Mississippi Supreme Court's decisions limiting a surety's liability for interest accruing prior to notice. Fairness also underlies the prohibition against the imposition of penalties by implication. The MTC's policy of refusing to provide notice to the surety and an opportunity to be heard is simply unfair. It does not comport with the mandates of due process and should not be upheld by this Court.

For all of the reasons set forth above, the judgments of the lower courts must be reversed and this case remanded for further proceedings on the Sureties constitutional claims.

This the 25th day of February, 2010.

Respectfully Submitted:

ST. PAUL FIRE AND MARINE INSURANCE COMPANY; TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA; FIDELITY AND GUARANTY INSURANCE COMPANY; AND THE UNITED STATES FIDELITY AND GUARANTY COMPANY

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CERTIFICATE OF SERVICE

I, the undersigned attorney, do hereby certify that I have this date, served a true and correct copy of the above foregoing document via United States Mail, postage prepaid upon the following attorneys, as follows, to-wit:

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Honorable Judge Patricia Wise
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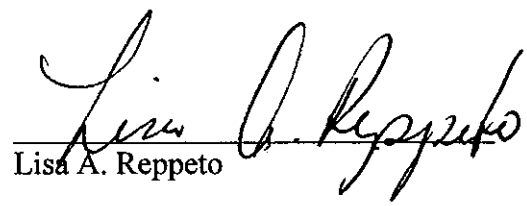
This the 25th day of February, 2010.



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