ORIGINAL

IN THE SUPREME COURT OF OHIO

DIRECTV, INC., and ECHOSTAR SATELLITE L.L.C., Plaintiffs-Appellants, v. RICHARD LEVIN, Tax Commissioner of Ohio, Defendant-Appellee.	:	Case No. 09-0627 On Appeal from the Franklin County Court of Appeals, Tenth Appellate District, Case No. 08AP-32

APPELLANTS' REPLY BRIEF

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INTRODUCTION[1]

The central claim in this case is that the Ohio General Assembly passed a differential tax with the purpose and effect of promoting businesses that build extensively in Ohio over businesses that do not—that the purpose of the differential is to favor the Ohio economy, to favor the businesses that hire thousands of Ohioans and contribute millions in property taxes and franchise fees over direct competitors that do not. Particularly in these economic times, most any politician might be inclined to retort, "Nothing wrong with that."

This brief is not addressed to the political branches, but to a Court—specifically, to a Court that has held that there *is* something wrong with a state legislature putting its thumb on the scale of competition by levying differential taxes on two virtually identical products in a way that gives "a direct advantage to its local economy." *Dayton Power & Light Co. v. Lindley* (1978), 58 Ohio. St.2d 465, 467, 12 O.O.3d 387, 391 N.E.2d 716. That rule is based on the bedrock constitutional principle, reinforced in multiple cases holding that a state may not tax interchangeable products or services at two different rates depending upon the extent to which the seller builds or maintains facilities within the state. The rationale behind this principle goes to the essence of the Commerce Clause: If every state interferes with free competition in the same way the General Assembly did here, *all* their citizens suffer.

There is no dispute as to what the General Assembly effectively accomplished with its differential tax: It taxed interchangeable products at two different rates depending upon whether or not the product is sold by a business that constructs and maintains thousands of buildings and lays thousands of miles of cable in the state (and concomitantly hires thousands of Ohioans). The Commissioner does not challenge Plaintiffs' assertion that it would be impermissible for the

[1] This brief uses the same abbreviations used in Plaintiffs' opening brief, which is cited as "OB." The Commissioner's brief is cited as "TC Br."

state to accomplish this result expressly, and fails to successfully distinguish the numerous cases from the U.S. Supreme Court and this Court that have held that it is impermissible for a legislature to achieve the same result in practical effect even without saying it explicitly.

Instead, the Commissioner and his amici echo the Court of Appeals' twin themes: that there can be no Commerce Clause violation if (1) both the beneficiaries and the victims of discrimination engage in interstate commerce; or (2) it is possible to point to some peripheral operational difference between the two businesses. Sixteen nationally renowned academics across the ideological spectrum—from Dean Kenneth Starr to Dean Erwin Chemerinsky—have joined a brief in their capacity as independent constitutional scholars to denounce these distinctions as a drastic departure from settled law. In contrast, apart from *retaining* some professors as *paid advocates*, neither the Commissioner nor the cable industry could recruit a single scholar to support the Court of Appeals' logic or result.

As the scholars know, the Commissioner is the one making the radical argument here, not Plaintiffs. The U.S. Supreme Court has explicitly rejected the Commissioner's first proposition, in a lengthy passage the Commissioner does not even address. That proposition is so wrong that the Commissioner's main ally here—the Ohio cable industry—derides it as "untenable." OCTA Br. at 2. As to the second proposition, the U.S. Supreme Court has never suggested that all bets are off, and the courts are no longer free to examine the actual effects or purpose of the distinction, so long as the state has identified some operational difference between two competitors. In fact, outside the satellite TV context, no court has ever suggested any such thing. Those satellite TV cases are wrong. An intensive examination of purpose and effect is *always* at the heart of a Commerce Clause claim. Those courts are no more expert than this Court at reading U.S. Supreme Court decisions, and they do not even give a nod to this Court's cases, most notably the above-quoted principle of *Dayton Power*. Independent analysis confirms the scholars' point that those courts misapprehended settled Commerce Clause principles.

Some amici (not coincidentally, the ones filed by representatives of the political branches) presume this Court will not exercise its independent judgment. See NCSL Br. at 1-2; NGA Br. at 13. They emphasize the magnitude of a possible refund, without acknowledging that the state's refund liability will be close to zero: As angry as the million Ohio satellite TV subscribers are about the discrimination they have suffered—particularly the rural families who pay a higher tax just because of where they choose to live (see NRTC Br. at 4-5)—experience confirms that only a tiny percentage of them will be able to (or will take the time to) secure years worth of back bills and file individual claims for refunds in the range of $40 a year. (See Appx. 23.3 (requiring individual claims).) If the General Assembly had adopted the evenhanded tax originally proposed, the state would have not only avoided the threat of a refund, but collected $825 million more than it did. There is nothing to stop the General Assembly from adopting that approach now, which would raise $125 million more each year than it currently collects.

Whatever the likely outcome, this Court has demonstrated time and again that it will not sacrifice constitutional principles for short-term fiscal concerns, and its job is not to save the General Assembly from its own folly in taking a path it knew to be constitutionally perilous.

ARGUMENT

I. THE SATELLITE-ONLY TAX DISCRIMINATES IN PRACTICAL EFFECT.

A. The Commissioner Never Disputed that Cable Companies Provide Far Greater Benefits to the Local Economy than Satellite TV Providers, and Could Not Sustain the Court of Appeals' Judgment on that Basis, Even If He Were Permitted to Dispute It Now.

The Commissioner's defense of the Court of Appeals' ruling revolves largely around disputing a fact that he never disputed throughout this litigation: Cable companies provide vastly greater benefits to the local economy than satellite TV companies. As the table below illustrates, and the trial court found as a matter of undisputed fact (Appx. 181-83), cable brings billions more in infrastructure to Ohio than satellite TV and thousands more jobs, paying hundreds of millions more in salaries. Cable has more employees in Ohio than DIRECTV has *in the entire country*. (TC Br. at 8-9; S.Supp. 120.) Nor has the Commissioner ever disputed that the difference in local footprint arises from the difference in modes of delivery that is the basis of the tax distinction. (See generally Supp. 1-6, 11-22, 55-248.) In fact, the Commissioner admitted all of this in his summary judgment briefing: "To be sure, because of the different technologies by which the services are distributed to customers, *cable television service possesses a local infrastructure and presence that DBS service does not require . . . .*" TC Br. ISO S.J., filed Jun. 16, 2004, at *16 (emphasis added).

Cable	**Satellite TV**
$2.32 billion in imbedded infrastructure in Ohio (Supp. 254).	$25 million in equipment in Ohio (TC Br. at 11; S.Supp. 1 at ¶¶ 1-2).
Pays more than $31 million in annual property taxes to Ohio (Supp. 254-55).	Pays only nominal property taxes (Supp. 255).
Over 6,000 employees in Ohio, paying wages in Ohio totaling more than $200 million per year (Supp. 254-55).	DIRECTV has one employee in Ohio (Supp. 4 at ¶ 12), and Echostar has none (Supp. 57, ¶ 9).
Pays $57 million in annual franchise fees to local governments (Supp. 254-55).	Pays no franchise fees to local governments, because does not use public rights-of-way (Supp. 255).
Runs over 63,000 miles of cable in Ohio, a vast web connecting every subscriber's home (Supp. 254).	Uses minimal cable in Ohio, none of it to subscribers' homes (S.Supp. 125-26).

The Commissioner may not now dispute what he conceded below. But even if he could, that would not sustain the ruling below. The Court of Appeals granted judgment *to the Commissioner* as a matter of law. The Commissioner cannot sustain the ruling by disputing facts that Plaintiffs presented, much less by disputing obvious facts that Plaintiffs established so definitively that the Commissioner never disputed them until now. This Court cannot sustain the

Court of Appeals' judgment unless it concludes that there is no Commerce Clause violation even if: (1) cable and satellite TV are competitors in the same business; (2) the state derived extraordinary benefits by favoring cable over satellite TV; and (3) the state adopted the distinction solely for that purpose.[2]

In any event, the Commissioner does not succeed in disputing the vastly different impact by noting that satellite TV companies have *some* property in Ohio (1% of what cable has); use *some* cable in Ohio (a minuscule fraction of cable's 60,000 miles); and employ *some* Ohioans (actually *one*, as against cable's 6,000). TC Br. at 8-11. These activities do not—and never will—amount to "enormous economic impact in Ohio" (id. at 27), at least not as compared to the cable behemoth. By any metric, the state enhances local economic interests when it grants cable a tax advantage over satellite TV.

B. The Satellite-Only Tax Discriminates Against Interstate Commerce Because It Depends on Whether or Not a Business Constructs Thousands of Buildings and Lays Tens of Thousands of Miles of Cable Within the State.

The Commissioner does not dispute that it would violate the Commerce Clause for the General Assembly to declare: "all pay TV services are taxed at a rate of 5.5%, except if the service provider constructs at least 2,000 buildings in Ohio, lays at least 60,000 miles of cable within Ohio's borders, and employs at least 6,000 Ohio workers." OB at 25-26. A multitude of cases—*Armco*, *Westinghouse*, and *Granholm*, to name a few—confirm as much. The Commissioner concedes that those cases would be controlling if "the challenged Ohio tax classification . . . treat[ed] more favorably a business that locates infrastructure in Ohio than a

[2] There is also no dispute that favoring the local economy was the basis on which the cable industry urged the General Assembly to burden satellite TV with a tax that cable need not pay. That point is relevant not only to the separate claim of discriminatory purpose that the Court of Appeals improperly dismissed without analysis (see OB at 47), but also to facets of the discriminatory effects claim. See infra at 13-17 (discussing "mode of business"). For reasons explained below (infra at 20), the Commissioner is incorrect in asserting that Plaintiffs waived the factual disputes about discriminatory purpose. TC Br. at 41-42.

business that elects to operate from outside the state." TC Br. at 34. But the satellite-only tax does *exactly* that, because the only way to reach 2.5 million subscribers with "ground equipment" is by "locat[ing] infrastructure in Ohio." So the Commissioner tries to distinguish the cases on other unpersuasive grounds or overstate the consequences of faithfully applying those precedents. His efforts are unpersuasive.[3]

Facial discrimination vs. discriminatory effect. The Commissioner begins by noting that the statutes in some of the key cases explicitly referred to building something *within the state*, whereas the satellite-only tax does not. Id. at 35. But as the Commissioner acknowledges elsewhere (id. at 22), a statute with the *practical effect* (or purpose) of rewarding only those companies that build a specified facility within the state is treated as if it said so explicitly.

Take *Dayton Power*: The tax statute did not say, "Coal produced in Ohio shall be taxed at a lower rate than coal produced out of state, because mining in Ohio means more jobs for Ohioans, more tax revenue for Ohio, and more economic activity in Ohio." It did not have to. The General Assembly used a proxy—sulfur content—that had the same practical effect as if it had used those words. And this Court struck the statute because of that *effect*. *Bacchus* is another example. The statute did not explicitly base the tax on who produced the beverages, where they did it, or where the fruits were from. On its face, the statute merely exempted alcoholic beverages made from specified fruit from a tax that was imposed on all other alcoholic beverages. One of those fruits was pineapple—which grows outside Hawaii (just like high sulfur coal can be found outside of Ohio). *Bacchus Imports Ltd. v. Dias* (1984), 468 U.S. 263, 265. On

[3] Contrary to the Commissioner's assertion, this Court has never held that a Commerce Clause violation must be proven "beyond a reasonable doubt." TC Br. at 23 (citing cases involving other constitutional provisions). Rather, this Court applies the burdens the Supreme Court has meticulously prescribed for Commerce Clause cases, which call for strict scrutiny and "'a virtually per se rule of invalidity'"—the opposite of beyond a reasonable doubt standard—once a statute's discriminatory effect is established. *Dayton Power*, 58 Ohio. St.2d at 469 (quoting *Philadelphia v. New Jersey* (1978), 437 U.S. 617, 624). In any event, there *is* no doubt about the differential impact of cable and satellite TV on the local economy, since the Commissioner conceded it.

the statute's literal terms, a pineapple wine made in California from pineapples grown in California would be tax-exempt. Nevertheless, the Court struck the tax differential as discriminatory against interstate commerce because "the *effect* of the exemption is clearly discriminatory." Id. at 271 (emphasis added). When the Court peered behind the statute's location-neutral terms, it became clear that the tax preference advanced Hawaii's own economy—and that was undoubtedly *why* the state legislature passed the statute.

So, too, here. It was obvious to the General Assembly what sort of infrastructure, and how many thousands of employees, were needed to reach 2.5 million subscribers with "ground equipment." A statute does not have to encase the discrimination in neon in order for the courts to recognize its obvious and intended effect.

Relocation of infrastructure. Next, the Commissioner tries to distinguish the various cases because they concerned statutes designed "to force businesses to locate part of their infrastructure in one state versus another," rather than simply burdening those businesses that did not. TC Br. at 35. Some, but not all. The point of the differential treatment in *Granholm* was not to encourage a California winery to build a facility in New York, but to burden the California winery with an expense that would make it less competitive—ultimately for the benefit of New York's local economy. *Granholm v. Heald* (2005), 544 U.S. 460, 471-76. The point of the tax differential in *Armco* was not to encourage wholesalers to manufacture in-state; it served much the same function that the Commissioner now argues the satellite-only tax serves, to offset a different tax that state imposed on manufacturing. *Armco Inc. v. Hardesty* (1984), 467 U.S. 638, 642. The tax differentials in *Dayton Power* and *Bacchus* were not designed to incentivize Pennsylvania coal companies to move their mines to Ohio, not to persuade Jim Beam to move to Hawaii, and not to persuade Seagram's to launch a brand of wine made from Hawaiian pineapples. They were designed to promote the state economy, by giving an economic edge to products and businesses more likely to contribute to the local economy. In each case, the statute fell because tipping the scale of competition in favor of the local economy constituted discrimination against interstate commerce.

"Relative local presence" test. The Commissioner frets that faithful application of these legal principles would require state legislatures and courts to apply a burdensome "'relative local presence' test." TC Br. at 30. But the "nightmare" that the Commissioner predicts bears no resemblance to the case law or to Plaintiffs' theory. Id. at 32. *Armco*, *Westinghouse*, and *Granholm* do not adopt—and Plaintiffs do not advocate—an audit of every "aspect of what each business does in Ohio." Id. at 26. So there is no need to worry that "relative in-state presence could literally change by the moment" and could vary from state to state. Id. at 32. Those cases turned on the state's decision to tax some businesses more and some less, *based on whether the business built (or used) some specified structure within the state* (a manufacturing plant, an export facility, and a distribution center, respectively). That is all the Court meant when it said that "discrimination based on the extent of local operations is itself enough to establish the kind of local protectionism that is prohibited" under the Commerce Clause. *Lewis v. BT Inv. Managers, Inc.* (1980), 447 U.S. 27, 42 & fn.9. At no point in any of these cases did the Court try to catalog the entire local presence of each beneficiary and weigh it against the entire local presence of each victim of the discriminatory tax. So it is not "factual gerrymandering" to focus only on the aspect of in-state activity that the state chose as the basis for the distinction. TC Br. at 26. It is faithful adherence to the analysis laid out in those cases.

In keeping with that analysis, this Court need look no further than the practical differences between delivering pay TV programming to millions of customers through cables vs.

directly from satellite "without the use of ground equipment." R.C. 5739.01(XX) (Appx. 215). Contrary to the Commissioner's assertion (TC Br. at 32), from the perspective of local economic footprint, *that* differential is both enormous and immutable. Indeed, the Commissioner confirms this point when he observes that cable and satellite TV will "ha[ve] the same relative presence in all states in which the companies do business." Id. at 32.[4]

Supercharged Equal Protection claim. Nor do Plaintiffs "suggest that states cannot differentiate between 'vigorous competitors in the same market'" (id. at 24 (quoting OB at 3)), or that the Commerce Clause can serve as "a new form of Equal Protection Clause, absolutely barring disparate treatment between two interstate competitors" (id. at 33). Plaintiffs clearly stated their "bottom line": As a general matter, the Commerce Clause does allow a state to tax companies differently, even if they "are in the same business and provide the same service to the same customers," but what the state may not do (at least not without compelling justification) is adopt a tax structure "to favor the service that builds and operates an extensive infrastructure in [the state] and penalize the service that does not." OB at 3. There is nothing new about this effects analysis. It is simply a recognition that a court may peek behind the statutory language of a tax differential, and take stock of the obvious facts on the ground, to discern its effect, just as this Court did in *Dayton Power* and the U.S. Supreme Court did in *Bacchus.*

Does that mean that legislators must pore over every tax statute and ask themselves whether this distinction or that happens to have unintended effects that favor the local economy? Of course not. A disfavored business cannot even allege discrimination against interstate commerce unless the legislature has imposed different tax rates on two equivalent products. Any

[4] This undisputed fact does not save a tax that is imposed on satellite TV but not cable from discriminating against interstate commerce. To the contrary, it only underscores the importance of the Commerce Clause in an increasingly national economy. In service of parochial interests, every state will have an incentive to squelch a *national* competitor—such as satellite TV companies or Amazon.com—that brings improved quality, convenience, or price competition to the benefit of all.

legislature that does so is *already* asking itself, "Why would we treat these two fungible products differently?"—or at least it should be. That is what happened here. The General Assembly had a bill to tax satellite TV and cable service *equally*, because, from the consumer's perspective, they are interchangeable. Cable persuaded it to distinguish the two products—with a message about all the local economic benefits that flow from favoring cable over satellite TV. When that happens, the General Assembly *should* be asking itself whether the tax has the promised effect and whether that is a permissible purpose. If the legislature opts to proceed despite the stated purpose and effects, it does so at its peril.

By way of example, the Commissioner repeatedly worries that the standard effects test requires a state to tax planes and space shuttles the same as trains, or trains the same as trucks and buses. TC Br. at 33. The question is not whether those different industries must all have the same tax structures, but whether their *customers* must be taxed the same when these different industries provide the *same service* and the state distinguishes them on a basis that translates into a disparate local benefit. On the one hand, it would be quite a stretch to say that space shuttles, airlines, and bus lines are similarly situated in that customers view them as essentially the same *transportation* service. On the other hand, the analysis is different where the state maximizes local economic benefit by taxing *the same sorts of products*—say, newspapers—differently, depending upon whether they arrive by airmail from afar or by bicycle. Here, based on undisputed facts, the trial court found that cable and satellite companies *are* similarly situated vis-à-vis the consumer (Appx. 107-16), which makes the latter illustration much more analogous.

Here is an even closer analogy: Imagine a consumer wanted to install a program on his computer—say, Microsoft Word. He could choose one of three modes of delivery: (1) downloading Word off the internet; (2) ordering discs to be hand-delivered; or (3) visiting a store to purchase discs in person. There would be serious Commerce Clause implications if the state chose to tax the first purchase and not the latter two, because the latter two were so much better for local jobs and the local economy. That is true, even though the tax statute says nothing about state boundaries, the location of an activity, or the use of local employees—but speaks only in terms of mode of delivery. Cf. *Granholm*, 544 U.S. at 473-76; *Cherry Hill Vineyard, LLC v. Lilly* (C.A.6 2008), 553 F.3d 423, 432-33.

C. The Court of Appeals' Two Rationales for Concluding There Was No Discrimination Against Interstate Commerce Are Flawed.

The Commissioner echoes the Court of Appeals' two arguments for why there was no discrimination against interstate commerce even if the discrimination in favor of cable has the unmistakable effect of advancing the local economy and the General Assembly acted with that motive. Sixteen independent scholars have taken the rare step of filing a brief with this Court asserting that these notions are foreign to Commerce Clause jurisprudence and would all but gut the clause. See Law Profs. Br. at 12-23. They are right.

1. It is irrelevant that both cable and satellite TV companies engage in interstate commerce.

The Commissioner goes to great lengths to disprove the proposition that cable companies are "inherently local" and satellite TV providers are "inherently" out-of-state. TC Br. at 28; see id. at 8-12. If anything should be evident from Plaintiffs' opening brief, it is that they are *not* resting their appeal on any such proposition. See OB at 18-21, 44. Nevertheless, the Commissioner persists in attributing the position to Plaintiffs. TC Br. at 28. His main point is to echo the Court of Appeals' lead argument: "[T]he dormant Commerce Clause analysis with respect to the Satellite and Cable Companies need not go beyond the essential fact that both businesses are interstate businesses engaged in predominantly interstate economic activity with respect to their Ohio subscribers." Id. at 25. Because the Commissioner believes that "[t]he

Commerce Clause . . . is directed at prohibiting individual states" only "from enacting laws that favor **local enterprises** at the expense of out-of-state businesses" (id. at 23 (emphasis in original)), he insists that a Commerce Clause argument depends on a court's ability to "segregate[]" entities "into interstate and local enterprises" (id. at 28 (quoting Appx. 19)).

The Commissioner does not grapple with all the authority—presented by both Plaintiffs and the 16 constitutional law scholars—that the law is exactly the opposite. OB at 17-32; Law Prof. Br. at 12-18. He does not even mention the U.S. Supreme Court's unequivocal statement that, in assessing a differential tax, it simply does not matter that the state is "discriminat[ing] between two types of interstate transactions." *Boston Stock Exch. v. State Tax Comm'n* (1977), 429 U.S. 318, 334-35 (quoted at OB at 28). He does not mention the Court's pronouncement that what matters in a Commerce Clause case—what is "constitutionally impermissible"—is to "favor[] local commercial interests," id., or this Court's point that it is impermissible to give "a direct advantage to its local economy," *Dayton Power*, 58 Ohio St.2d at 467. The Commissioner does not address the fact that the victims and beneficiaries alike in *Armco*, *Westinghouse*, and *Granholm* were *all* engaged in interstate commerce, or the table in Plaintiffs' opening brief documenting other cases reflecting the same pattern. See OB at 32. The Commissioner's argument is so baseless that even his biggest ally—the Ohio Cable Trade Association ("OCTA")—pans it as "an untenable proposition of law." OCTA Br. at *2. It agrees that "discriminat[ing] based on status, such as residency or state of incorporation" is only "[o]ne way in which states can run afoul of the dormant Commerce Clause." Id. at *5-6 (citing *Bacchus*, 468 U.S. at 285-86). As the Commissioner acknowledges (TC Br. at 23), the "basic purpose of the Clause" is "to prohibit the multiplication of preferential trade areas destructive of the free commerce anticipated by the Constitution." *Maryland v. Louisiana* (1981), 451 U.S. 725, 754.

That can be done by favoring a local state *economy*—by passing a discriminatory tax that "benefit[s]" "in-state . . . economic *interests*," *Or. Waste Sys. v. Dep't of Envtl. Quality* (1994), 511 U.S. 93, 99—not just by elevating purely local entities over purely out-of-state entities.

In the face of all this, the Commissioner merely follows the Court of Appeals' lead in quoting two lower court decisions in other satellite TV cases. See TC Br. at 25-26. They are no more persuasive in the Commissioner's brief than they were in the opinion below. See OB at 42-44.

2. *Exxon* and *Amerada Hess* do not allow a state to adopt distinctions with the practical effect or purpose of favoring the local economy.

The Commissioner treats "mode of operation" as some sort of constitutional trump card, as if the courts must ignore both the *practical effects* of a statutory distinction and the legislature's actual *purpose*, so long as the legislature couched a distinction in terms of technological differences. If the Commissioner is right, then a state *could* take the most blatantly protectionist step of taxing a product delivered by downloading it off the internet higher than the same product bought in-person or delivered by hand. The state could insist that the court must ignore the benefits for the local economy, and any evidence of blatant protectionist motive. It would insist, as the Commissioner does here, that the state has merely distinguished "two very different means of delivering" goods, and "this difference, and not the geographic location of the businesses," is what "drives whether or not a particular service is taxable." TC Br. at 39.

As the scholars point out, the Commissioner is wrong. Law Profs. Br. at 19-23. The one "pervasive theme running through Supreme Court review of state taxation cases" is that empty labels are no substitute for scrutiny of the "'actuality of operation.'" *Dayton Power*, 58 Ohio St.2d at 469 (citation omitted). Where, as here, the undisputed evidence shows that the *effect* of a distinction is to favor the local economy, the statute discriminates against interstate commerce.

A state cannot insulate itself from any examination of purpose and effect by couching a distinction in terms of an operational or technological difference—any more than it can use any other attribute (such as sulfur content or type of fruit) as a proxy for local favoritism. Once again, the Commissioner points to no case (outside the satellite context) that has ever read *Amerada Hess* or *Exxon* as an authorization to use a statutory reference to technology to trump the ordinary inquiry into purposes and effects.

The Court did not take any such analytical shortcut in *Amerada Hess* and *Exxon*. In those cases, the Court did not blithely conclude that the statute invoked a mode of business, and call it a day. It rigorously analyzed the purpose and effect of the statutes in question. After that rigorous analysis, the Court simply could not see how either statute could be condemned as protectionist in purpose or effect. In *Amerada Hess*, the state did not favor the local economy by declining to grant the petroleum industry a preferential tax break that the state did not grant to big businesses that were prevalent in the state. See *Amerada Hess Corp. v. N.J. Dep't of Treasury* (1989), 490 U.S. 66, 76-78. Likewise, in *Exxon*, the Court could not see how prohibiting oil companies from owning retail pumps could be cast as anything other than what was claimed—a measure to protect the public from petroleum companies that exploit oil crises. *Exxon Corp. v. Maryland* (1978), 437 U.S. 117, 119-21, 125-28. The measure did not reward or encourage investments in Maryland (in fact, it blocked a whole category of ready investors); it did not encourage, protect, or reward local ownership of filling stations (anyone—local or foreign—could buy a retail station, so long as it was not an oil company); and it did not stimulate the local economy (if the stations could not be sold and were shut down, there would be fewer jobs and less business). In short, in each case, "mode of business" was a label the Court affixed to the *conclusion* that there is no discrimination against interstate commerce. It was not an excuse for avoiding all analysis.

The Court underscored the point by emphasizing that this rationale applies only when a court can confidently conclude that the differential treatment "results *solely* from differences between the nature of their businesses, *not from the location of their activities*." *Amerada Hess*, 490 U.S. at 78. (emphasis added). The Commissioner repeatedly focuses on the words "nature of their businesses," but ignores both "solely" and the explicit caveat that if a statutory distinction, as a practical matter, bears any relation to "the location of [specified] activities," then the principle is inapplicable.

The point is also underscored by the holdings in *Bacchus* (which *Amerada Hess* embraced and distinguished) and *Dayton Power*. In *Bacchus*, it was not enough for the state to say, "We are not discriminating on the basis of interstate commerce, but only the nature of the product; a seller of pineapple wines and okolehao are in a different business from Jim Beam and Seagrams." In *Dayton Power*, it was not enough for Ohio to say, "We are not discriminating on the basis of interstate commerce, but only on the basis of sulfur content. Sulfur-rich coal is a different product from low-sulfur coal." In each case, this Court and the U.S. Supreme Court cut through formalistic distinctions to ask, "What is the real-life effect of the distinction? Why would a state choose to make the distinction?"

So, too, here. Faithful adherence to these cases—as well as *Amerada Hess* and *Exxon*—requires this Court to peer past the superficial assertion that "Satellite Companies distribute their broadcasting services by significantly different technologies," TC Br. at 39, and examine the practical effect and purpose of that distinction. Nowhere is the disconnect between these precedents and the Commissioner's position clearer than in his assertion that "the adverse impact of Ohio's tax differentiation between the Satellite Companies and the Cable Companies is due solely to their unique and different modes of operation, and not to a requirement that either business must locate operations in Ohio in order to receive favorable treatment." Id. at 37-38. In practical terms, *it's the same thing*: The *only* way cable companies can serve 2.5 million Ohio customers through "ground equipment" is by building the intricate web of ground equipment *in Ohio*, and the only way to do that is by having armies of workers in Ohio. The technological differences necessarily translate into vastly different benefits to the local economy, just as surely as the differences between high-sulfur coal and low-sulfur coal translate into vastly different benefits to the local economy.

At points (particularly in the passage quoted immediately above), the Commissioner seems to be arguing that the General Assembly did not adopt the statutory scheme *because* of the impact on the local economy, but despite it. See, e.g., id. at 37-38. As an initial matter, that is, of course, a factual question, which could not possibly be resolved against Plaintiffs—as the Court of Appeals did—on summary judgment. See infra at 20. Paradoxically, the Commissioner concedes that "the use of orbital satellites cannot be the distinguishing feature of the two pay technologies, because cable providers also receive much programming via satellite at the headend centers." TC Br. at 28. Moreover, the Commissioner's ultimate justification—that cable pays franchise fees for rights-of-way and satellite TV providers do not—does the Commissioner no good, because franchise fees, too, are a function of where the business builds. In the end, the discrimination has nothing to do with technology and everything to do with geography. In any event, that assertion about purpose does not erase the unmistakable effect—which suffices to establish discrimination against interstate commerce. At that point, the state has the burden of demonstrating that its alternative explanation is not only the actual purpose, but that it survives strict scrutiny.

II. THE DISCRIMINATORY TAX CANNOT BE JUSTIFIED AS COMPENSATING FOR CABLE'S COMPLETELY DIFFERENT BURDEN OF PAYING LOCAL GOVERNMENTS FRANCHISE FEES IN RETURN FOR PROPERTY RIGHTS.

Once Plaintiffs have demonstrated that the satellite-only tax discriminates against interstate commerce, the case is practically over. "'[A] virtually per se rule of invalidity has been erected'" for laws that discriminate against interstate commerce. *Dayton Power*, 58 Ohio St.2d at 469 (quoting *Philadelphia v. New Jersey* (1978), 437 U.S. 617, 624). "[J]ustifications for discriminatory restrictions on commerce [must] pass the strictest scrutiny." *Or. Waste*, 511 U.S. at 102. The Commissioner has offered only one alternative justification: that the state tax on satellite TV offsets a burden that cable alone bears, the burden of paying local franchise fees. TC Br. at 45. This asserted justification fails at the outset, because the Commissioner has not demonstrated that this was the legislature's purpose as a matter of undisputed fact.

In any event, as the Commissioner acknowledges, the Supreme Court has developed an intricate doctrine—the compensatory tax doctrine—that revolves around defenses just like this one, and makes them exceedingly hard to prove. Id. A tax can be justified as compensatory only in the narrowest of circumstances, when a state has levied a tax on interstate activity to compensate for *the same kind of tax* imposed on intrastate activity. See, e.g., *Fulton Corp. v. Faulkner* (1996), 516 U.S. 325, 344; *Or. Waste*, 511 U.S. at 102-03. Thus, the Supreme Court has upheld a discriminatory use tax on interstate business that compensated for an equivalent sales tax on intrastate business. *Or. Waste*, 511 U.S. at 105. But it has expressed "extreme reluctance" and "doubt" as to whether the doctrine could apply "outside the limited confines of sales and use taxes." *Fulton*, 516 U.S. at 344. As the trial court acknowledged below, if an exception exists to this rule, this is certainly not it. (Appx. 183-85.)

Confronted with a standard that he could never meet, the Commissioner has taken the novel stance that a far less rigorous standard applies where, as here, a statute discriminates in practical effect rather than facially. See OB at 45 fn.11. No court has ever suggested any such thing. The same strict scrutiny standard applies whether a statute discriminates on its face, or in effect or purpose. See, e.g., *Dayton Power*, 58 Ohio St.2d at 468-69; *W. Lynn Creamery v. Healy* (1994), 512 U.S. 186, 201. While the U.S. Supreme Court first articulated the rigors of the compensatory tax doctrine in the context of a case that happened to involve a "facially discriminating" statute, *Fulton*, 516 U.S. at 331 fn.2, the Court has since applied the same strictures to a compensatory tax argument offered to justify discrimination "borne out in practice," *S. Cent. Bell Tel. Co. v. Alabama* (1999), 525 U.S. 160, 169.

Accordingly, the Commissioner cannot prevail unless he shows "that the requirements of the compensatory tax doctrine are clearly met": (1) he must identify a *tax* burden the state is attempting to counter, *Or. Waste*, 511 U.S. at 103; (2) "the tax on intrastate commerce must be shown roughly to approximate—but not to exceed—the amount of the tax on intrastate commerce," id.; and (3) "the events on which the interstate and intrastate taxes are imposed must be substantially equivalent; that is, they must be sufficiently similar in substance to serve as mutually exclusive proxies for each other," *Fulton*, 516 U.S. at 333 (citations omitted), and they must be imposed for the same purpose, *Maryland v. Louisiana*, 451 U.S. at 758.

The Commissioner does not even come close. First, franchise fees are not taxes, and cable does not pay them to the state. Cable companies negotiate franchise fees voluntarily and at arms-length in return for a direct benefit—a property right—to lay their cables on public property. Cable companies readily admit that franchise fees are a "form of rent"—not taxes—that "are commonly understood to be consideration for the contractual award of a government benefit." *City of Dallas v. FCC* (C.A.5, 1997), 118 F.3d 393, 397. Second, the discriminatory tax on satellite is not equivalent to the franchise fees that cable companies pay certain Ohio municipalities. While satellite companies pay a uniform state sales tax of 5.5%, franchise fees vary from municipality to municipality and are *capped* at 5%. OB at 13. In some Ohio municipalities, satellite TV subscribers pay a 5.5% state sales tax, while the cable subscriber next door pays a 3% franchise fee. (Supp. 122.) The Supreme Court has rejected the compensatory tax defense where, as here, the equality of the tax and fee is, at best, "a matter of fortuity, depending entirely upon the locality in which the purchaser happens to reside." *Associated Indus. v. Lohman* (1994), 511 U.S. 641, 649. Third, the state tax and cable franchise fees are not imposed on "substantially equivalent . . . events," *Fulton*, 516 U.S. at 333 (citations omitted), let alone for the same purpose. The discriminatory tax is a general tax assessed on all satellite TV subscribers in the state, with the purpose of raising revenue for the state. The tax is nothing like the franchise fees that cable companies contractually pay for the right to lay cables under and over the public roads and rights-of-way. (See, e.g., Supp. 109-75.)

In sum, assuming that the state's sole purpose was to offset franchise fees, all that means is that the state has opted to impose a higher burden on satellite TV providers to offset a cost of doing business that cable companies alone have to pay in order to deliver their service. As the trial court accurately concluded, far from "leveling the playing field" between cable and satellite, the satellite-only sales tax actually creates discrimination in favor of cable by depriving satellite companies "of the benefit of a superior competitive characteristic that they possess (the satellite provider's lack of need to pay for access to public right-of-ways)." (Supp. 183-84.)[5]

[5] The Commissioner and several amici alternatively argue that § 602 of the Telecommunications Act of 1996, 47 U.S.C. § 152, condones the discrimination in Ohio's statute. That claim is baseless. That statute merely prohibits local governments from taxing satellite TV, while preserving the power to tax at the state level. The statute "reflects a legislative determination that the provision of direct-to-home satellite service is national, not local

III. THE COURT OF APPEALS ERRED IN GRANTING THE COMMISSIONER JUDGMENT ON THE DISCRIMINATORY PURPOSE CLAIM THAT THE TRIAL COURT HAD FOUND TO PRESENT TRIABLE FACTS.

The Commissioner is incorrect in asserting that Plaintiffs waived their Commerce Clause claim premised on discriminatory purpose. TC Br. at 41-42. The trial court denied cross-motions for summary judgment on that issue. (Appx. at 167, 185-95.) In so ruling, the trial court granted Plaintiffs a trial in which they could prove their claim of discriminatory purpose. Because the factual question of the statute's purpose was never resolved against Plaintiffs, they did not have to appeal to preserve their position that the purpose was discriminatory. This Court cannot affirm the Court of Appeals' conclusion that there was no discriminatory purpose because it cannot decide that disputed factual question as a matter of law on this record.

CONCLUSION

For the foregoing reasons, this Court should reverse the Court of Appeals and reinstate the trial court's grant of summary judgment in Plaintiffs' favor.

Dated: January 25, 2010

Respectfully submitted,

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in nature." 142 Cong. Rec. H1152 (1996). Nothing in the Act or its legislative history suggests that the same Congress that sought to relieve satellite TV providers of local-tax burdens simultaneously invited *discriminatory* taxes at the state level. As one amicus acknowledges (albeit in a footnote), a federal law cannot be read to authorize discrimination unless the permission is "clearly expressed." MTC Br. at 5 n.6. A statute that merely authorizes a state to impose a tax—without saying a word of authority to discriminate—does not "clearly express[]" permission to impose a *discriminatory* tax. See *Gen. Motors Corp. v. Tracy* (1997), 519 U.S. 278, 303-311.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the *Appellants' Reply Brief* was served by U.S. mail, postage prepaid, this 25th day of January, 2010, upon the following:

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