

1 IN THE SUPREME COURT OF THE UNITED STATES

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3 DEPARTMENT OF REVENUE :

4 OF KENTUCKY, ET AL., :

5 Petitioner :

6 v. : No. 06-666

7 GEORGE W. DAVIS, ET UX. :

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9 Washington, D.C.

10 Monday, November 5, 2007

11

12 The above-entitled matter came on for oral
13 argument before the Supreme Court of the United States
14 at 11:05 a.m.

15 APPEARANCES:

16 C. CHRISTOPHER TROWER, ESQ., Atlanta, Ga.; on behalf of
17 the Petitioners.

18 G. ERIC BRUNSTAD, JR., ESQ., Hartford, Conn.; on behalf
19 of the Respondents.

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1 P R O C E E D I N G S

2 (11:05 a.m.)

3 CHIEF JUSTICE ROBERTS: We'll hear argument
4 next in Case 06-666, Department of Revenue of Kentucky
5 v. Davis.

6 Mr. Trower.

7 ORAL ARGUMENT of C. CHRISTOPHER TROWER

8 ON BEHALF OF THE PETITIONERS

9 MR. TROWER: Mr. Chief Justice, and may it
10 please the Court:

11 Kentucky's tax exemption for municipal bond
12 interest paid by Kentucky and its political subdivisions
13 to Kentucky taxpayers treats all private entities the
14 same, and favors only Kentucky and its political
15 subdivisions. This Court has never held that a law
16 which favors government, whether the State or local
17 government, rather than private business enterprises
18 violates the dormant Commerce Clause.

19 The Court's decision last term in United Haulers holds
20 that State laws which favor government but which treat
21 all private business entities in State and out of State
22 the same does not discriminate against interstate
23 commerce.

24 JUSTICE ALITO: Is what you just said true
25 about conduit bonds, where Kentucky issues bonds to

1 finance private construction? Is the statement that you
2 just made accurate?

3 MR. TROWER: Yes, it is, Your Honor.

4 Private activity bonds, a subset of which are conduit
5 bonds, account for approximately 20 percent of all
6 municipal bonds issued. And I think your question has,
7 has two point to it.

8 First of all is whether or not a State or a
9 municipality ought to be able to use its tax exempt
10 borrowing power to further a project chosen by the
11 municipality to achieve public purposes, such as for
12 example tax exempt hospitals or other facilities that
13 are tax exempt, should it be able to use that tax exempt
14 borrowing power constitutionally? The answer there is,
15 yes. Congress has already made that decision.

16 The second question is whether there's a
17 Commerce Clause problem if a State exempts it's own
18 private activity bonds but taxes private activity bonds
19 issued in other States?

20 JUSTICE ALITO: That's what you do, isn't
21 it?

22 MR. TROWER: Yes, sir.

23 JUSTICE SOUTER: Doesn't that raise, in
24 effect, sort of a distinction between Carbone and United
25 Haulers? Or at least one way of understanding the

1 distinction between those two cases? In Carbone the
2 facility, in fact, was not the facility of the
3 government.

4 MR. TROWER: That's correct.

5 JUSTICE SOUTER: Here the, the immediate
6 beneficiary of the bonds is, in Justice Alito's hypo, is
7 a private entity?

8 MR. TROWER: That's correct, that the
9 immediate beneficiary of the bonds or of the loan is a,
10 is a nongovernmental entity. It's not necessarily a
11 private business.

12 As we point out in our reply brief, 80
13 percent of all private activity bonds go for --

14 JUSTICE SOUTER: But -- correct me if I'm
15 wrong, just a matter of fact. I thought in most
16 instances the immediate beneficiary would be a private
17 entity who, in effect, was enabled to borrow at a lower
18 rate?

19 MR. TROWER: That is correct. It would be a
20 nongovernmental entity that would be able to borrow at a
21 tax exempt rate.

22 JUSTICE SOUTER: So don't you have to
23 take -- therefore, if you're going to answer Justice
24 Alito as you did, don't you have to take the position
25 that Carbone really is not good law and the

1 Carbone/United Haulers distinction is not a -- is simply
2 not a relevant distinction?

3 As a dissenter in Carbone, I naturally do
4 not find that the worst answer you could give.

5 (Laughter.)

6 JUSTICE SOUTER: But don't you have to give
7 that answer?

8 MR. TROWER: I thought the distinction that
9 you drew in your dissenting opinion in Carbone between
10 the one entity that has got to get the job done within
11 the jurisdiction is the key distinction in observing
12 United Haulers.

13 JUSTICE ALITO: Well, as a dissenter in
14 United Haulers, I also don't think it's a good
15 distinction.

16 (Laughter.)

17 JUSTICE ALITO: But couldn't there be
18 instances where some, an industrial, a company is trying
19 to -- is deciding to locate a plant and is choosing
20 between Kentucky and Ohio, and Kentucky says, come to
21 Kentucky because we'll issue private activity bonds so
22 that you can finance this more cheaply than if you went
23 into Ohio? And when you do that, aren't you, aren't you
24 doing exactly what the dormant Commerce Clause is
25 supposed to prevent?

1 MR. TROWER: No. You're doing -- the
2 dormant Commerce Clause in no way restricts the ability
3 of States to provide economic incentives for in-State
4 business activity.

5 JUSTICE GINSBURG: Mr. Trower, were private
6 activity bonds considered at all below? As far as I
7 understand, this is not a private activity bond, it's
8 not, what's at issue here. And there was no
9 adjudication with respect to that type of bond --

10 MR. TROWER: That's exactly --

11 JUSTICE GINSBURG: -- in the lower courts.

12 MR. TROWER: That is exactly right, ma'am.
13 And our position is that Respondents have no standing to
14 make a claim focused solely on private activity bonds,
15 because there is no evidence in the record as to whether
16 Respondents own any private activity bonds.

17 JUSTICE BREYER: Suppose that you -- and I
18 have the same hypothetical for both you and your
19 brothers on the other side with some adjustment here,
20 because I'm finding the case quite difficult. And the,
21 the -- for you, imagine we have some milk producers in
22 Kentucky. They are farmers. And they go to the
23 legislature and they say, you know, we can sell a lot
24 more milk in Kentucky if you will pass a law imposing a
25 tax on Missouri farmers who want to ship milk into

1 Kentucky. That's the classic unlawful -- all right.
2 It's unlawful, unconstitutional, right.

3 MR. TROWER: Yes, sir.

4 JUSTICE BREYER: All right. Now, what is
5 the difference if a city in Kentucky that wants to
6 finance its schools says now to the legislature, we're
7 going to find it easier to sell bonds in Kentucky or
8 elsewhere, in Kentucky, for our school system if you'll
9 only put a tax on similar bonds that Missouri is
10 offering to finance their city schools? That will help,
11 just like the milk. Now, what's the difference?

12 MR. TROWER: The difference is, is twofold.
13 One, the favoritism in the first example, the dairy
14 cases, which have come up a million times, is a
15 favoritism of a private industry, whereas in your second
16 hypothetical the favoritism is to the most public of
17 industries, education.

18 The second difference is that a tax on
19 out-of-State dairy products increases the cost of
20 out-of-State dairy products to in-State consumers with
21 no detriment to in-State dairy producers, whereas, as
22 our Respondents have pointed out in their brief, when a
23 tax is imposed by a government on a transaction where
24 the government itself is paying the money, which is what
25 we have here, a tax on interest income paid by the

1 government, the effect is to impose a dollar-for-dollar
2 reduction in the government's tax revenues equal to the
3 amount of the exemption. So you've got an in-State
4 entity, namely, the government itself, that is suffering
5 a revenue loss.

6 That's not at all comparable to the dairy
7 hypothetical.

8 JUSTICE BREYER: We have consumers in the
9 dairy products that are suffering loss. They're all the
10 voters in the States. Everyone drinks milk.

11 MR. TROWER: Yes, sir.

12 JUSTICE BREYER: So they are suffering a
13 dollar-for-dollar loss, because their milk becomes more
14 expensive.

15 I don't know if that's analogous. I think
16 it's a pretty strong analogy. As to the first, that's
17 of course the point that's worrying me. It is true that
18 this is a public matter.

19 MR. TROWER: Yes, sir.

20 JUSTICE BREYER: Would it make a difference
21 in the first case if it happened to be some dairy
22 farmers who -- there are so few in Massachusetts now,
23 unfortunately, that they all work on State-owned dairy
24 farms that are put up for, you know -- does it make a
25 difference?

1 MR. TROWER: I think it would make a
2 difference.

3 JUSTICE BREYER: It would make a difference?

4 MR. TROWER: If a hamburger stand is owned
5 by the State, it's okay under United Haulers. If the
6 State wants to go into the dairy business, the Commerce
7 Clause doesn't prevent the state from doing that.
8 That's our answer, is that the Commerce Clause does not
9 extend to activities by a State on behalf of all of its
10 people.

11 CHIEF JUSTICE ROBERTS: We have a different
12 variation here that wasn't present in United Haulers,
13 which, of course, is that Kentucky does compete with
14 other public entities in the municipal bond market. In
15 other words, I think you have a strong case with respect
16 to discrimination against private bonds, but Kentucky
17 competes against Ohio bonds as well. And they're making
18 the Kentucky bonds more attractive through this
19 discriminatory tax on the Ohio bonds.

20 Why isn't that a sufficient distinction from
21 United Haulers?

22 MR. TROWER: The key distinction in the
23 United Haulers, Mr. Chief Justice, was between an entity
24 with the responsibility for the welfare of the citizens
25 within the jurisdiction versus all other entities. It

1 just happened to be in United Haulers that that was a
2 public entity versus private entities. But United
3 Haulers, we submit, would have reached exactly the same
4 result if the trash haulers had wanted to take the
5 garbage to a municipal or a public facility in New
6 Jersey, as opposed to a private facility in New Jersey.

7 And the second answer to your question is
8 that other public entities, other States, other
9 municipalities have no responsibilities in Kentucky for
10 the public welfare. They're no different than private
11 borrowers in Kentucky. They don't have sovereign
12 immunity in Kentucky if they default on their bonds.
13 They can be sued in Kentucky court. That's the
14 essential difference.

15 The question I think that the Justice Breyer
16 brought up would also lead me to talk about what are the
17 purposes of the Commerce Clause writ large, or the
18 dormant Commerce Clause not writ large, that have
19 motivated this Court's jurisprudence? I think there are
20 three: Economic protectionism, which the Court has
21 repeatedly said does not apply to activity by the State
22 on its open behalf; secondly, the free market or free
23 trade rationale, which has motivated many of the Court's
24 decisions, but at the same time the Court has always
25 been careful to say that the free trade rationale, Maine

1 v. Taylor for example, does not value free trade above
2 all other values that we have. And we would submit that
3 the value here is the fundamental sovereignty of the
4 States.

5 Our political system subdivides
6 responsibility for government and responsibility for
7 public works in America. Bonds are not issued by the
8 States to make a profit or to leverage their return on
9 equity. Bonds aren't issued to create an investment
10 opportunity for Wall Street or for Main Street. Bonds
11 are issued to finance the essential work of government.
12 And this Court's decision should look at that part of
13 the equation as much more significant and weigh those
14 values much more heavily than the values of the free
15 market, which don't really apply to the State's
16 provision of goods and services. In all the dairy cases
17 --

18 JUSTICE KENNEDY: Suppose a State said that
19 it was unlawful for anyone other than a State resident
20 to purchase the bond?

21 MR. TROWER: That would be completely
22 constitutional.

23 JUSTICE STEVENS: What if -- what if the
24 State offered its taxpayers a higher interest rate than
25 purchasers from other States? Would that be

1 permissible?

2 MR. TROWER: Yes, sir, that would be totally
3 permissible and would achieve the same result as the
4 exemption that we've got here. So what you've got
5 before you is --

6 JUSTICE ALITO: How would that achieve the
7 same result if these bonds weren't negotiable and they'd
8 be hard to sell, hard for you to sell, if people who
9 bought them couldn't sell them, and they could sell them
10 to somebody out of State and get the higher interest
11 rate?

12 MR. TROWER: I thought the question was if
13 the bonds increased the interest rate and limited the
14 purchasers to Kentucky citizens.

15 JUSTICE ALITO: And these would be bonds
16 that Kentucky citizens could not sell to anyone else?

17 MR. TROWER: They could sell them to anyone
18 else.

19 JUSTICE ALITO: Anyone who wasn't a Kentucky
20 citizen?

21 MR. TROWER: It would be -- let me back up.
22 I think I got ahead of myself there.

23 It would be entirely constitutional for a
24 State to offer bonds for sale and limit the sale to
25 Kentucky residents and limit the payment of interest to

1 Kentucky residents and have a mechanism to assure that
2 that would be the case. For example, contract
3 submissions by brokers. The SEC does that right now
4 thousands of times each day with Rule 144 sales. The
5 administrative mechanism would be there. Would it be
6 constitutional? Yes, sir. Our point is we've got a
7 giant market upon which the States depend for the
8 financing of public goods and services.

9 JUSTICE KENNEDY: Would it be constitutional
10 to say that the holder of the bond must always be a
11 Kentucky resident or, if you sold the bond, it has to be
12 to another Kentucky resident?

13 MR. TROWER: Yes, it would be. We've got
14 the same analogy in the securities law, where the
15 intrastate exemption is conditioned upon the holder of
16 the security being an in-State resident who must agree
17 not to transfer the security out of State.

18 CHIEF JUSTICE ROBERTS: Well, I suppose you
19 could achieve the same result simply by providing you're
20 not going to pay interest to somebody who is not a
21 Kentucky resident.

22 MR. TROWER: Yes, sir, you could.

23 JUSTICE KENNEDY: So if New York has a very
24 strong financial community, it can really benefit its
25 citizens by keeping the market in New York bonds for

1 itself, if it chooses?

2 MR. TROWER: Yes, it could.

3 JUSTICE KENNEDY: And your case for that is
4 what, United Haulers?

5 MR. TROWER: Yes, sir, as well as an
6 attention -- as I was going to earlier, the larger
7 principles that are behind the dormant Commerce Clause
8 jurisprudence of the Court. The Court has -- we talked
9 about economic protectionism. We talked about the free
10 trade rationale. And then the third rationale which
11 comes up often in the Court's opinions is political
12 solidarity. That is to say that the Commerce Clause was
13 not a grant of power to the national government to enact
14 free trade laws, but rather it was a grant of power to
15 the national government to prevent Union-dividing
16 friction between the States.

17 We don't have that friction here. All 49
18 States support Kentucky's position. Where that
19 political friction is not an issue, the need for
20 judicial invalidation of the laws of 42 States is
21 commensurately less.

22 On the other hand, what are the things that
23 we think that the Commerce Clause doesn't require --
24 doesn't require the States to do? It doesn't require
25 the States to give up incentives to local business

1 activities within the State. The Commerce Clause
2 doesn't throw into the maw of the free market, the --

3 JUSTICE STEVENS: How do you reconcile that
4 with the Bacchus case?

5 MR. TROWER: Well, Bacchus was a case which
6 favored the in-State pineapple wine producers --

7 JUSTICE STEVENS: Correct.

8 MR. TROWER: -- with a tax.

9 JUSTICE STEVENS: I've always thought it was
10 incorrectly decided, to be honest with you, but it's
11 there. It's been there a long time.

12 MR. TROWER: That doesn't surprise me at
13 all, Justice Stevens, because your concurring opinion in
14 Alexandria Scrap said the same thing. We agree with
15 that position.

16 CHIEF JUSTICE ROBERTS: So we have to
17 overrule Bacchus to agree with you?

18 (Laughter.)

19 MR. TROWER: No, sir. No, sir. The
20 suggestion that we're making here today is that a tax
21 exemption which applies directly and exclusively to the
22 payment of money by a government to its direct trading
23 partners is all you're dealing with here. That would
24 not change the result in Bacchus, Boston Stock Exchange,
25 or any of the other discriminatory tax cases because all

1 of those cases involved a -- a tax or an exemption.

2 CHIEF JUSTICE ROBERTS: Does your argument
3 depend upon the uses to which Kentucky is putting these
4 proceeds?

5 MR. TROWER: No, sir.

6 CHIEF JUSTICE ROBERTS: Well, I thought it
7 would because you're saying nobody else is responsible
8 for public works in Kentucky and so on.

9 MR. TROWER: I'm sorry, Mr. Chief Justice.
10 I thought you meant it made a difference whether they
11 spent them on an airport or --

12 CHIEF JUSTICE ROBERTS: No. Just a public
13 facility.

14 MR. TROWER: Yes, sir. Governmental.

15 CHIEF JUSTICE ROBERTS: So, if Kentucky had
16 a law that it could only -- no out-of-State car dealer
17 could sell cars in Kentucky, that benefited Kentucky car
18 dealers, and then it had a special tax on Kentucky car
19 dealers to fund local hospitals, airports, roads,
20 whatever -- that would be all right?

21 MR. TROWER: I don't think that would be all
22 right. I think that's the West Lynn Creamery case in
23 reverse.

24 CHIEF JUSTICE ROBERTS: So it doesn't
25 matter? So the use to which the proceeds are put

1 doesn't save an otherwise discriminatory activity?

2 MR. TROWER: The -- it is the -- it is the
3 entity which chooses the use to which the proceeds are
4 put that determines the Commerce Clause situation. The
5 choice of -- of sewers, airports, schools, that's up to
6 the governmental entity to make.

7 I'll reserve my time for rebuttal.

8 CHIEF JUSTICE ROBERTS: Thank you,
9 Mr. Trower.

10 Mr. Brunstad.

11 ORAL ARGUMENT OF G. ERIC BRUNSTAD, JR.

12 ON BEHALF OF THE RESPONDENTS

13 MR. BRUNSTAD: Mr. Chief Justice, and may it
14 please the Court:

15 This is a tax case and that makes a
16 difference. It's not a case about a monopoly, and
17 what's key about that is that Kentucky has not taken
18 over the national municipal bond market. It hasn't
19 taken over the market. It is trying to regulate the
20 market with this facially discriminatory tax. It is
21 facially discriminatory because on its face the statute
22 says if you buy in Kentucky an in-State bond you have a
23 tax exemption. If you're in Kentucky and you buy the
24 out-of-State bond, we tax you. This is no different
25 from the Bacchus case or the Fulton case or Boston Stock

1 Exchange.

2 CHIEF JUSTICE ROBERTS: Or United Haulers.

3 MR. BRUNSTAD: It's very different, Your
4 Honor. Oh, no, it's very different, Mr. Chief Justice,
5 from United Haulers. There inherent in the power to
6 take over -- the State took over the local trash
7 handling market -- the power to create a monopoly is the
8 power to exclude all competition.

9 Here Kentucky does not have a monopoly.
10 They merely issue the commodity. Then, once it is in
11 private hands, an interest in being paid.

12 JUSTICE BREYER: Then of course you win as
13 soon as we say the commodity is the same as milk.
14 Obviously to me you would, but that's the issue. And in
15 United Haulers what the question was, I thought, is if
16 it is a traditional governmental function, anyway --
17 say, like producing electricity, or cleaning the
18 streets -- there they discriminate and say you have to
19 buy in State -- well, it's different, and indeed it may
20 be okay.

21 So what you've just heard your brother --
22 brother argue is if this is a fortiori, because here
23 it's not even making electricity; it's not even
24 collecting trash; it is financing the most basically
25 governmental of all governmental institutions --

1 libraries, schools, streets.

2 Now, why isn't it a fortiori from United
3 Haulers, given the nature of the task that they are
4 raising the money to finance?

5 MR. BRUNSTAD: Three reasons, Justice
6 Breyer. First, as this Court stated in Oregon Waste,
7 the purpose of or justification for a law has no bearing
8 on whether it is facially discriminatory. Secondly, as
9 this Court held in Bacchus, as long as there is some
10 competition between the locally produced exempt product
11 and nonexempt products from outside the State, there is
12 a discriminatory effect. Here if you look at what --
13 what are these bonds?

14 JUSTICE STEVENS: Can a State --

15 JUSTICE BREYER: You're arguing -- but can a
16 State do this? It produces a service or product; it
17 sells the service or product to in-State people at a
18 price 50 percent less than it sells to out-of-State
19 people.

20 MR. BRUNSTAD: Certainly, Your Honor. Under
21 the market participant doctrine, if -- if you want to
22 sell cement and you own the State-owned cement plant,
23 you can choose. You recall in South-Central --

24 JUSTICE BREYER: No, no, you're saying if
25 the State owns cement, it can sell 50 percent less to

1 its in-State citizens than out-of-State?

2 MR. BRUNSTAD: That's what this Court held
3 in Reeves v. Stake.

4 JUSTICE BREYER: Fine. Then could it do
5 this? Could it say that if you buy cement from
6 out of State, the answer is no, right?

7 MR. BRUNSTAD: Through a tax, no. And I
8 think the Court's precedent in South-Central --

9 JUSTICE BREYER: All right. Suppose what
10 they are selling is education? Can the University of
11 California say that when you send your child to the
12 University of California, you will get a thousand
13 dollars back on your income tax. But if you send the
14 child to an out-of-State school, you don't?

15 MR. BRUNSTAD: There the State is supplying
16 educational services to its citizens, and under the
17 market participant doctrine that would be fine. I think
18 this hypothetical --

19 JUSTICE BREYER: Well if that's fine, then
20 what they say is we sell you participation in the
21 financing of the project.

22 MR. BRUNSTAD: But that's not what the tax
23 --

24 JUSTICE BREYER: And if you buy -- we sell
25 you the participation. It's called a bond, and if in

1 fact you give the money to us, and you are in-State, you
2 get a thousand dollars back. But if in fact, when you
3 do the identical thing, and you buy a similar thing from
4 out-of-State, you do not get the money back? How is
5 that different from what you just said was okay in
6 respect to the University of California?

7 MR. BRUNSTAD: Justice Breyer, that would be
8 a subsidy, and this Court drew the very distinction in
9 the New Energy case as the difference between subsidy
10 and a tax. And that I think is absolutely critical; and
11 I think here Justice Holmes' admonition that a page of
12 history is worth a volume of logic makes sense. The
13 rallying cry for the American Revolution was "no
14 subsidies without representation," it was "no taxation
15 without representation."

16 JUSTICE BREYER: No, I'm sorry, then I
17 wasn't clear in the hypothetical. The hypothetical was
18 that you get a thousand-dollar rebate on your income
19 tax. So I was trying to make it exactly like this case.
20 You pay a lower State tax.

21 MR. BRUNSTAD: But I think -- I think there
22 you would look through the form to the substance, and
23 the substance there is we will charge you X amount for
24 tuition and we are giving you part of that back as a
25 rebate. That is no different from a subsidy. Here is

1 completely different, Your Honor.

2 JUSTICE GINSBURG: Why is it any different
3 from a tax credit?

4 MR. BRUNSTAD: Well here, Your Honor, as the
5 Court made plain -- made plain in the Camps case, Camps
6 Newfound/Owatonna, a tax exemption is not the sort of
7 direct State involvement in the market that falls within
8 the market participation doctrine. There is a key
9 difference between a tax and a subsidy.

10 JUSTICE SOUTER: But in that case, the only
11 thing the State was doing was taxing. Here in Justice
12 Breyer's hypothetical, in the case we've got, the State
13 is also participating in a bond market.

14 MR. BRUNSTAD: No, Your Honor, not in -- the
15 part that they are taxing is not their participation
16 part. I think a hypothetical will crystalize this.

17 JUSTICE SOUTER: Why do we draw that line?
18 I mean, you -- a moment ago you were talking about the
19 -- the realities of subsidy. Why don't we confront the
20 realities of -- of the fact that the State's
21 participation in the bond market and the -- and the tax
22 exemption go together hand in hand? It's unrealistic to
23 divide them.

24 MR. BRUNSTAD: Because, Justice Souter,
25 there is a fundamental difference between the two. A

1 tax tears down; a subsidy builds up. If you want to
2 subsidize your local park --

3 JUSTICE SOUTER: So what? The economic
4 reality is precisely the same.

5 MR. BRUNSTAD: But not constitutionally,
6 Justice Souter, and here is why --

7 JUSTICE SOUTER: Not constitutionally, we
8 have said, in cases in which the State is not acting
9 purely as the regulator. Here the State is not acting
10 purely as the regulator. The State has a dual capacity,
11 and you say ignore one side of that capacity for the
12 other; and my question is why?

13 MR. BRUNSTAD: Because, Justice Souter, here
14 what the State is taxing is the out-of-State commodity.
15 It is taxing -- it is doing a downstream regulation.
16 The State issues a commodity -- just like in
17 South-Central; the State issued the timber; the State
18 owned the timber, and then it imposed a downstream
19 regulation on the purchase --

20 JUSTICE SOUTER: Yes, but it's not taxing an
21 out-of-State commodity in the sense of a commodity which
22 is manufactured or produced out-of-State.

23 MR. BRUNSTAD: But Your Honor, it's no
24 different than the Boston Stock Exchange case, where we
25 are talking about securities -- or in Fulton, Your Honor

1 -- shares of stock.

2 JUSTICE SOUTER: In which case the State was
3 not a participant, but the State is here.

4 MR. BRUNSTAD: But the State is using its
5 taxing power to regulate -- to regulate interstate
6 commerce, whereas in United Haulers, Chief Justice
7 Roberts, there was no tax. There was no discriminatory
8 tax. And inherent in the power to create a monopoly is
9 the inherent power to preclude competition. Here there
10 is competition. There is economic gamesmanship, Justice
11 Souter. They want to sell their bonds nationally but
12 hoard their own investment dollars locally, which is
13 precisely --

14 CHIEF JUSTICE ROBERTS: So you want to
15 suggest -- I'm sorry.

16 JUSTICE SOUTER: No. Please.

17 CHIEF JUSTICE ROBERTS: Are you suggesting
18 that the result in United Haulers would have been
19 different if there were a competing trash processing
20 facility out-of-State?

21 MR. BRUNSTAD: No, Your Honor, because there
22 again we have a monopoly. The State took over the
23 entire market -- the trash disposal facility of
24 recycling and everything else in the United Haulers
25 case. Inherent in the power to create a monopoly is the

1 power to exclude competition. There is no
2 discrimination by definition.

3 Here they have not taken over the market.
4 They are imposing a downstream regulation by taxing the
5 out-of-State commodity, and the distinction is
6 exactly --

7 CHIEF JUSTICE ROBERTS: Well, they are not
8 taxing the out-of-State commodity. Their tax is imposed
9 simply on Kentucky taxpayers.

10 MR. BRUNSTAD: I think, Chief Justice
11 Roberts, the analysis that the Court made in the New
12 Energy case is directly on point and addresses this.
13 There the Court said the Commerce Clause does not
14 prohibit all State action designed to give its residents
15 an advantage in the marketplace, but only action of that
16 description in connection with the State's regulation of
17 interstate commerce. Direct subsidies of domestic
18 industry does not ordinarily run afoul of that
19 prohibition; discriminatory taxation does. Again --

20 JUSTICE SOUTER: And this situation is
21 somewhere in between the two. Because although we do
22 not have what in form is a subsidy, we have what in
23 economic reality is a subsidy for the benefit of the
24 State's own activity as a bond issuer.

25 So the question again is, why do we accept

1 your characterization that this case should be treated
2 exactly as if the State were acting merely in a
3 regulatory capacity?

4 MR. BRUNSTAD: Because Justice Souter, the
5 entire purpose of the dormant Commerce Clause
6 jurisprudence is to protect the integrity of the market.
7 If Kentucky wants to have a subsidy and say we are going
8 to subsidize our own residents, fine. That builds up
9 something in Kentucky.

10 JUSTICE SOUTER: And the whole purpose of --
11 of the combined effect of market participant for the --
12 acting for the purpose of providing an essentially
13 governmental service is to give the State a free hand.
14 Why do we ignore that in your argument in favor simply
15 of the regulatory side?

16 MR. BRUNSTAD: Because, Justice Souter, what
17 they are doing here is imposing a facially
18 discriminatory tax. They have the burden of saying,
19 under the Court's precedents, they have no other
20 alternative.

21 JUSTICE SOUTER: But the question is whether
22 it will be treated as we treat a facially discriminatory
23 tax when there is no market participation, there is no
24 State participation for the purpose of providing a
25 fundamental governmental service. If -- if in fact

1 there is a good reason to treat them differently, then
2 we don't follow the -- the facial discrimination test.

3 Let me -- let me ask a -- a question with
4 that as the premise. Assuming -- and I obviously do
5 assume -- that we have a choice of analysis here, one
6 good reason to choose the analysis that your brother
7 has -- that the State is forwarding is the fact that we
8 have historically a bond market which has grown up since
9 New York issued the first tax-exempt or -- a bond.

10 MR. BRUNSTAD: In 1919, Your Honor.

11 JUSTICE SOUTER: And we have an enormous
12 market, the effect of interrupting which we really, as a
13 Court, cannot tell very much. And that seems to me a
14 very good reason to give the nod to the -- to the market
15 participant, the essential services side of what the
16 State is doing, as opposed to the regulatory side, and
17 simply confront the thing under Pike.

18 Why isn't that a good reason?

19 MR. BRUNSTAD: Because, Justice Souter, this
20 case represents a classic race to the bottom where the
21 only reason why we have these discriminatory tax laws is
22 because New York started it in 1919.

23 It wanted to hoard its own local investment
24 dollars and yet sell its bonds nationally.

25 Every other State caught on, and that

1 creates a problem in the marketplace which the dormant
2 commerce claim --

3 JUSTICE BREYER: Well, you have a perfectly
4 good remedy in respect to that. If the States don't
5 like this race to the bottom, they need only create a
6 compact or go to Congress.

7 MR. BRUNSTAD: But a compact is precisely,
8 Your Honor, what the dormant commerce clause was
9 designed to prevent -- States coming together and trying
10 to create regional compacts or trying to create favored
11 trade deals among themselves.

12 JUSTICE BREYER: You know, I was only -- I
13 was only addressing your point that there was a
14 practical problem. Insofar as there is a practical
15 problem, it seems to me the States have a perfectly good
16 remedy even if they lose this case.

17 MR. BRUNSTAD: Even if they lose this case
18 --

19 JUSTICE BREYER: Or win the case, whatever.

20 MR. BRUNSTAD: But Justice Breyer, the whole
21 point --

22 JUSTICE BREYER: However.

23 MR. BRUNSTAD: I think -- I think that the
24 Court's analysis in Quill is on point here. In the
25 Court's analysis in Quill the Court said look, we have

1 this very clear rule that says States cannot engage in
2 facially discriminatory taxation. They can't do it.

3 And if, in fact, we are wrong -- if, in
4 fact, the Court's precedent creates a problem, then it's
5 something that Congress can easily fix. The States can
6 go to Congress.

7 CHIEF JUSTICE ROBERTS: But our approach in
8 the General Motors case was the exact opposite. There
9 we couldn't figure out whether the market for natural
10 gas was captive or not captive.

11 It was a little of each, and we kind of said
12 well, you know, if it's kind of a close question, leave
13 it for Congress. Because, after all, the Commerce
14 Clause talks about Congress' power. The dormant
15 Commerce Clause is not mentioned.

16 So this is an area where Congress can
17 regulate if it wants to, and it has never shown the
18 slightest interest in interfering with State tax
19 exemptions for their own bonds.

20 MR. BRUNSTAD: But, Chief Justice Roberts,
21 the same could have been said for the problem in
22 Granholm, where 26 States had the same no direct
23 shipment problem; or the same problem in Bacchus where
24 36 States had the same discriminatory alcohol tax laws.
25 Congress didn't --

1 CHIEF JUSTICE ROBERTS: It strikes me as
2 much more fundamental, whether or not a State can issue
3 a tax exemption for its -- its bonds. That seems more
4 fundamental than the more specialized issues in those
5 other cases.

6 And I think we have said when you're dealing
7 with a specialized issue that may not get the attention
8 of Congress, we have a different approach.

9 MR. BRUNSTAD: But, Chief Justice Roberts,
10 Congress is as unlikely to address this problem now that
11 it's so pervasive as it was to address the problem in
12 Granholm, or the problem in Bacchus, or any of those
13 other cases, or the problem in Fulton. Congress has
14 plenty of other things to do.

15 JUSTICE BREYER: That argument cuts against
16 you in context, I think. You're saying in every case of
17 any kind of discrimination one could go to Congress.
18 Absolutely right.

19 And since that's true of every case, now we
20 are back to the more basic question, leaving the
21 practicalities that you were talking about out of it, of
22 whether this case is more like the cows. Is it more
23 like the garbage collection?

24 MR. BRUNSTAD: Correct.

25 JUSTICE BREYER: Or is it on the far side of

1 the garbage collection, even a stronger case for
2 permission under the Commerce Clause?

3 MR. BRUNSTAD: Justice Breyer, this case is
4 like milk. That's what that --

5 JUSTICE BREYER: That's where I wanted you
6 to begin.

7 MR. BRUNSTAD: If you look at -- it is -- it
8 is, Chief Justice Breyer. If you look at bonds,
9 municipal bonds -- and we have some samples of an
10 Alabama bond and a Kentucky bond in the supplemental
11 appendix.

12 These are standardized forms that are traded
13 as commodities like any other securities. They have the
14 same regulatory overlay, which is distinct from General
15 Motors v. Tracy.

16 CHIEF JUSTICE ROBERTS: But it's not
17 distinct from United Haulers. Garbage is garbage, too.

18 MR. BRUNSTAD: That's true.

19 CHIEF JUSTICE ROBERTS: But the fact that
20 bonds are bonds doesn't seem to me to be very
21 responsive.

22 MR. BRUNSTAD: But the point -- two points,
23 Chief Justice Roberts -- one is that in United Haulers
24 we did not have a tax on the out-of-State commodity
25 coming in. Here we do.

1 The second thing -- and I think this is
2 critical -- we have a monopoly.

3 JUSTICE STEVENS: You didn't have a tax on
4 the out-of-State. You have an income tax charged to
5 Kentucky residents on their income from that bond. It's
6 quite different.

7 MR. BRUNSTAD: But, Justice Stevens, that
8 points out how this is a downstream regulation. The
9 State's participation ends when it is done issuing the
10 bond. It goes to underwriters who then trade them in
11 the privately-owned national bond market, no different
12 than in South Central.

13 The State of Alaska owned the timber. It
14 sold the timber in the marketplace. Then it sought to
15 impose this downstream regulation.

16 It would be the same as if New York City
17 said, we have a local water company, and we have a
18 monopoly. And now we have someone who we are licensing,
19 a private business, to bottle that water to sell. And
20 we are slapping a tariff on Poland Springs from Maine,
21 because we want to protect the local business.

22 That's what's happening here. The State has
23 already issued the commodity. It is now in the
24 marketplace, and now they are basically prohibiting the
25 sale of it, or they are restricting the sale, by a

1 discriminatory -- in essence, tariff.

2 If you live in Kentucky, we want to
3 discourage you from buying a Michigan bond. And they do
4 it by saying we will tax the interest on the -- on the
5 out-of-State bond, and not tax the interest on the
6 in-State bond. They are giving themselves a leg up.

7 And one of the pernicious aspects of this is
8 that it has the effect of pooling capital within the
9 national market. It has the effect of creating this
10 discriminatory barrier.

11 JUSTICE STEVENS: The victims under your
12 approach, as I understand it, are the 49 other States,
13 and all of them seem to support your opponent in the
14 briefs that were filed in this case.

15 MR. BRUNSTAD: True, Justice Stevens, but
16 they don't want to issue refunds. You can understand
17 that. A short-term gain for a long-term solution that
18 would make them all better off, that would end this race
19 to the bottom.

20 My clients, the Davises, are penalized
21 because they are engaging in interstate commerce. They
22 are penalized. Because they own out-of-State bonds,
23 they pay a tax.

24 CHIEF JUSTICE ROBERTS: Your argument that
25 you just presented in response to Justice Stevens'

1 question, I think, relies on the discrimination against
2 the out-of-State issuers.

3 MR. BRUNSTAD: Correct.

4 CHIEF JUSTICE ROBERTS: Your clients are not
5 out-of-State issuers.

6 MR. BRUNSTAD: That's true.

7 CHIEF JUSTICE ROBERTS: We don't have an
8 overbreadth doctrine under the Commerce Clause. Why
9 aren't their arguments limited to discrimination against
10 them rather than discrimination against out-of-State
11 issuers?

12 MR. BRUNSTAD: Well, for the same reason
13 that it wouldn't be limited with the -- the taxpayer in
14 Fulton or the in-State taxpayer in Bacchus, where they
15 are basically arguing that this affects interstate
16 commerce.

17 And as illustrative of that, we are saying
18 look, in Bacchus you had the local brandy, and the local
19 pineapple wine got a tax rate.

20 CHIEF JUSTICE ROBERTS: So your Kentucky
21 taxpayers can argue about the discrimination against
22 out-of-State bond issuers?

23 MR. BRUNSTAD: They can argue about the
24 discriminatory effects of this law on the marketplace as
25 a whole, because they are participants in the market.

1 They are penalized for engaging in interstate commerce,
2 the same way that all of the same arguments were
3 presented in the Bacchus case with an in-State taxpayer,
4 the Fulton case with an in-State taxpayer.

5 And the Court has basically made that plain
6 in the New Energy case. You don't have to demonstrate
7 that there is some overwhelming, you know, sky is
8 falling problem. Any discrimination with respect to
9 interstate commerce, any discriminatory effect,
10 basically --

11 CHIEF JUSTICE ROBERTS: How do we know that
12 your clients will be better off regardless of how this
13 case is resolved? One way to resolve it, of course,
14 would be to take away the Kentucky tax exemption, which
15 would hurt your clients.

16 Another way to resolve it would be to extend
17 the tax exemption to the Ohio bonds, which may hurt your
18 clients if the Kentucky bonds aren't competitive, and
19 the price of the Kentucky bonds goes down. They are
20 going to lose either way.

21 MR. BRUNSTAD: The remedy, Your Honor, would
22 be for the State to decide whether it wants to make all
23 municipal bonds tax-exempt or to make them all taxable.

24 Now, in Kentucky there is a constitutional
25 provision which says they cannot -- they basically

1 cannot have their own bonds other than tax-exempt.

2 So unless they change their constitution,
3 the result would be to make all the bond, municipal
4 bonds, tax-exempt in Kentucky, which, of course, would
5 benefit my clients, who hold out-of-State municipal
6 bonds. But consider this --

7 CHIEF JUSTICE ROBERTS: But whether or not
8 it benefits them, it seems to me, depends on how
9 competitive they are with other States' municipal bonds.

10 In other words, their advantage now comes
11 from the tax exemption for Kentucky bonds; and it's not
12 clear, if that is eliminated across the board, that
13 Kentucky bonds are going to be competitive with, you
14 know, bonds of whatever other State. So the value of
15 them may go down, and your clients may lose, whether you
16 win or not.

17 MR. BRUNSTAD: But, Chief Justice Roberts,
18 consider these two critical points:

19 One cardinal principle of investment is
20 diversification. These discriminatory tax laws
21 basically compel people to hold only the bonds within
22 their particular State. Prospectuses for these
23 single-State bond funds say: Warning -- not diverse.
24 The second thing is their higher cost.

25 CHIEF JUSTICE ROBERTS: I mean it -- it

1 provides an advantage depending on the level of the
2 State income tax and, I suppose, the level of the
3 exemption. It doesn't necessarily mean that that's the
4 only bonds they are going to hold.

5 MR. BRUNSTAD: But that simply means that if
6 the State has a very high income tax, say, in
7 California, that's all the more reason, all the more
8 penalty, for people who want to engage in interstate
9 commerce and diversify their portfolios.

10 CHIEF JUSTICE ROBERTS: And it's less of a
11 problem if it's like Kentucky, which, I assume, has a
12 lower income tax.

13 MR. BRUNSTAD: Kentucky has a lower income
14 tax, but I think on the -- on the problem that was
15 raised, what if we -- if we affirm in this case, what
16 would the impact be?

17 Well, the State of Kentucky has said,
18 itself, that if it has to pay out refunds, we are
19 talking about a \$4 million per year refund obligation
20 the State of Kentucky has said it will have to pay.

21 The sky is not going to fall. What would
22 happen is that bond prices might adjust, but we would
23 have the free national market with interstate trade and
24 municipal bonds unimpaired by these artificial
25 constraints. These artificial discriminatory tax

1 regimes create artificial demand. They pull assets.
2 They hoard assets, local investment dollars, within
3 particular States. And you have a problem where, say,
4 cash-scarce States like, for example, Tennessee have
5 more of a restricted access to capital markets like New
6 York. If you're an investor in New York and you have
7 money to spend in municipal bonds, you're discouraged
8 from buying Tennessee bonds; you're encouraged from
9 buying New York State municipal bonds. The relatively
10 capital-scarce States are harmed. Again, people like
11 the Davises, they are harmed, they are penalized from
12 engaging in interstate commerce.

13 JUSTICE KENNEDY: I can ask your brother who
14 represents Petitioner -- maybe I'd better should -- I'd
15 get a better answer from him so far as his position.

16 As you understand his position, as you
17 understand the State's position, would it be permissible
18 for State A to go to State B and say: We -- if you make
19 your bonds nontaxable to our residents, we'll make your
20 bonds nontaxable to your residents.

21 MR. BRUNSTAD: We actually have that,
22 Justice Kennedy. Ohio, when it enacted its
23 discriminatory tax scheme here similar to Kentucky's, it
24 basically said: We will tax the bonds of an
25 out-of-State State, unless they do not tax Utah bonds.

1 So -- but you can see that clearly illustrates, to me --

2 JUSTICE KENNEDY: Do you find that
3 consistent with the vision of the framers for our
4 national market under the Commerce Clause?

5 MR. BRUNSTAD: Inconsistent, Justice
6 Kennedy. Inconsistent. This is nothing more than an
7 ongoing low-level trade war. It was started by New York
8 in 1919, when it basically created this discriminatory
9 tax scheme for itself. It basically incentivizes all
10 the States to follow suit. And it's easy to understand
11 why.

12 JUSTICE GINSBURG: What about the example
13 that was given of a interstate compact, say, to operate
14 a port authority that covers a few States, and the
15 compacters agree that they are not going to tax the
16 income on bonds issued by the port authority, but they
17 are going to tax the income from out-of-State municipal,
18 but it's only the bonds from this port authority. So
19 they -- it seems your theory would reach that too.

20 MR. BRUNSTAD: It would, Justice Ginsburg.

21 JUSTICE GINSBURG: And yet Congress has
22 approved compacts that say just that.

23 MR. BRUNSTAD: But where Congress
24 specifically speaks to permitting a particular practice,
25 then it can't violate the dormant Commerce Clause. Here

1 Congress has not spoken. The States are doing this on
2 their own.

3 And, Justice Kennedy, again, it is
4 completely inconsistent with the vision of the framers
5 because what's happening here, again, is the race to the
6 bottom, where New York said: All right, we're going to
7 sell our bonds nationally; ah, we're going to create an
8 investment for all the capital in New York to stay in
9 New York.

10 And you can see why every other State
11 afterwards said: Oh, look what New York is doing. We
12 have to follow suit to try to equal the playing field.
13 And, again, that is at the heart of the ongoing
14 low-level trade war with the --

15 CHIEF JUSTICE ROBERTS: Well, it assumes
16 it's all in the definition of your market. If your
17 market is tax-exempt bonds nationwide, it's one thing;
18 but your brother says the market ought to be people who
19 issue bonds for public works in Kentucky, and Kentucky
20 is the only one who does that so there is no
21 discrimination against anyone else because nobody else
22 is similarly situated to Kentucky with respect to
23 Kentucky public works.

24 MR. BRUNSTAD: But, Chief Justice Roberts,
25 here it's easy to tell what the market is. Kentucky

1 municipal bonds, in spite of the tax discrimination,
2 sell in a national, single market. There is a national
3 Federal overlay. Under Federal income tax purposes,
4 they're all tax exempt. They're all regulated under the
5 same Federal securities laws. The fraud parts of the
6 securities laws apply. They all compete for each other.
7 It's the fact that they compete for each other.

8 JUSTICE STEVENS: Is there any evidence in
9 the record as to how much -- what percentage of the
10 Kentucky bonds are bought by Kentucky residents?

11 MR. BRUNSTAD: There is no good data on that
12 information, Justice Stevens. We do not have an answer
13 to that. But I think the point --

14 JUSTICE STEVENS: Does it -- do we have it
15 for any State?

16 MR. BRUNSTAD: No, we do not, Justice
17 Stevens. We do not.

18 CHIEF JUSTICE ROBERTS: Well, I thought it
19 was inherent in your argument that most of them -- I
20 mean, if you're talking about hoarding capital, it
21 doesn't work very well if a lot of people outside
22 Kentucky are buying these bonds. There's not much
23 Balkanization if they're circulated widely. I thought
24 that your argument depended on the proposition that most
25 of these bonds are bought by Kentucky residents.

1 MR. BRUNSTAD: There is Balkanization, but
2 it's not complete Balkanization, just like the tax in --
3 that Hawaii imposed on the alcohol didn't prevent the
4 sale of fine California chardonnay imported into Hawaii;
5 it just promoted the sale of the locally produced wine.
6 It doesn't have to be a complete ban, as this Court
7 explained in Limbach, a complete ban or a discrimination
8 that imposes a burden. There's no constitutional
9 difference.

10 And that applies here too, but the market
11 criteria the Court applied in GMC versus Tracy, I think,
12 applies here. You don't look to define the market by,
13 gee, what's going to happen or what's the purpose of the
14 particular discrimination? You look at ordinary
15 commercial factors. And here the ordinary commercial
16 factors are there is one national market in which these
17 standardized commodities trade. They're issued by the
18 State. They're owned by individuals. Kentucky doesn't
19 own the bonds. Kentucky issues them. They are then
20 traded in the national market.

21 JUSTICE STEVENS: -- not really standardize.
22 Even without a tax exemption, residents of Kentucky
23 would be interested in public improvements in Kentucky
24 and have -- give a slight edge in the market to all
25 Kentucky bonds. I think there would be just a natural

1 preference for locally issued bonds.

2 MR. BRUNSTAD: And if they choose to do
3 that, that's fine.

4 JUSTICE STEVENS: And not totally fungible.

5 MR. BRUNSTAD: And of course that would not
6 be prevented by having nondiscriminatory taxes.

7 JUSTICE STEVENS: No, but it's a fact of the
8 market, it seems to me, that Kentucky bonds are
9 characteristically more attractive to Kentucky citizens
10 than they are to out-of-State citizens.

11 MR. BRUNSTAD: But, Justice Stevens, I think
12 that's an idiosyncratic value, not shared. Most
13 investors care about yield and --

14 JUSTICE KENNEDY: I assume there would be a
15 preference to Massachusetts milk for Massachusetts
16 buyers, to Michigan automobiles for Michigan buyers, and
17 the State did not subsidize.

18 MR. BRUNSTAD: But, Justice Kennedy, that
19 strikes me as the argument that Japan made --

20 JUSTICE KENNEDY: -- authorities --

21 MR. BRUNSTAD: Justice Kennedy, that strikes
22 me as the argument that Japan made when it said: We
23 should keep American made skis out of the Japanese
24 market because Japanese snow is different from American
25 snow. I mean you can't use those kinds of

1 justifications to say --

2 CHIEF JUSTICE ROBERTS: Well, that's not
3 fair because Kentucky is going to use the proceeds of
4 the bonds to build a hospital, a school that is going to
5 serve Kentucky residents.

6 MR. BRUNSTAD: But --

7 CHIEF JUSTICE ROBERTS: So there's -- it's
8 not just emotional attachment to Kentucky that would
9 promote the purchase of those bonds by Kentucky
10 residents. It's self-interest. They want a public
11 hospital nearby, and, therefore, it makes sense to buy
12 the hospital bonds.

13 MR. BRUNSTAD: But, Chief Justice Roberts,
14 every tax serves a public purpose. Every tax is for the
15 State's purposes. If this Court opens the door in this
16 case to say that this facially discriminatory tax regime
17 is okay, this Court will open the door to all of the
18 discriminatory taxes the Court has heretofore struck
19 down. This case -- this Court's discriminatory tax
20 precedents --

21 CHIEF JUSTICE ROBERTS: There's a very --
22 there's a very big difference between -- and it gets to
23 the difference with the Wisconsin cows, which was
24 addressed in United Haulers. That's a tax on private
25 activity, and private actors don't have the

1 responsibility of providing government services.
2 Kentucky does.

3 MR. BRUNSTAD: But every State does that.
4 And I think we need to maintain three clear
5 distinctions: Taxes, monopolies, and subsidies. They
6 are constitutionally distinct. Why? If you look at the
7 Constitution, you see all kinds of restrictions on
8 discriminatory taxes. There is no --

9 CHIEF JUSTICE ROBERTS: You don't see a
10 dormant Commerce Clause, though.

11 (Laughter.)

12 MR. BRUNSTAD: But the -- this Court's
13 dormant Commerce Clause precedents are directed to
14 preserving the integrity of markets. Once you stray and
15 you do not have those clear lines between monopolies,
16 United Haulers, discriminatory taxes, and subsidies,
17 then I think you make -- you take what is a very clear
18 monument of economic freedom, this idea of no
19 discriminatory taxes certainly not discriminatory taxes
20 on their face, and you blur those distinctions and you
21 pull down this monument the Court has.

22 As the Court -- for the reasons the Court
23 said in Quill, these distinctions are important. If
24 Congress, in this particular area, does not like the
25 result, it can change the result. But,

1 jurisprudentially, we need to maintain a distinction
2 between subsidies, between monopolies, and between
3 taxes. Again --

4 JUSTICE GINSBURG: The Court, in that old
5 Bonaparte case, it was just kind of very naive because
6 the Court made a decision that didn't -- that State A
7 can't create bonds that are going to be exempt from tax
8 in other States, right?

9 MR. BRUNSTAD: Not quite, Justice Ginsburg.
10 That was a full-faith-and-credit case in which the
11 Maryland resident said: Oh, I own out-of-State bonds;
12 therefore Maryland can't tax me because the out-of-State
13 State wouldn't tax me if I lived there. A completely
14 different issue, Your Honor. This issue was not before
15 the Court in Bonaparte.

16 Thank you.

17 CHIEF JUSTICE ROBERTS: Thank you,
18 Mr. Brunstad.

19 Mr. Trower, you have 12 minutes remaining.

20 REBUTTAL ARGUMENT OF C. CHRISTOPHER TROWER
21 ON BEHALF OF THE PETITIONERS

22 MR. TROWER: Let's start with the idea that
23 the Kentucky tax penalizes Respondents for participating
24 in interstate commerce. The answer there is no. The
25 Kentucky tax affords a direct trading partner, that is

1 to say a person that owns Kentucky bonds, a quid pro
2 quo. If a Kentucky taxpayer loans money to Kentucky,
3 Kentucky gives a tax exemption to that person that loans
4 money to Kentucky. If a Kentucky resident chooses to
5 loan money to California by buying California bonds, no
6 tax exemption is afforded.

7 But that different treatment is not a
8 penalty, we would submit, but rather a recognition that
9 the Kentucky resident who loans money to Kentucky is
10 entitled to receive something in return.

11 CHIEF JUSTICE ROBERTS: Well, why do you
12 care, Mr. Trower? I mean, if you lose your tax
13 exemption, it means you've got to pay more interest to
14 sell your bonds, but it also means you're going to get
15 taxes that you don't get now. Isn't it kind of a wash?
16 Does it really matter.

17 MR. TROWER: It matters tremendously, Your
18 Honor. Seventy-five percent of all municipal bonds
19 issued in America are issued by municipalities, local
20 agencies, and those bonds -- under \$10 million in
21 principal amount -- those bonds account for only 7
22 percent of the total volume of bonds outstanding. We
23 pointed this -- citations for this are in our reply
24 brief.

25 The significance would be that many

1 municipalities might have no market access at all for
2 their bonds. An investor could ignore 75 percent of all
3 bonds that are issued.

4 CHIEF JUSTICE ROBERTS: Yes, but the State's
5 going to have more money from their income taxes, and if
6 they want to spend it on a project in a particular
7 municipality, they will be free to do that.

8 MR. TROWER: They would be and that's
9 correct, Mr. Chief Justice. But that choice is a choice
10 that the Commerce Clause lets the States make, the
11 choice to either raise taxes or to have a tax exemption.

12 JUSTICE ALITO: It seems to me you're making
13 a lot of arguments that, if accepted, would -- maybe
14 this isn't true of all of your arguments, but certainly
15 many of them would demonstrate that the Commerce Clause
16 jurisprudence is utterly incoherent. If taxation is the
17 same thing as a subsidy, if congressional inaction is
18 the same thing as approval, if Kentucky bonds are not
19 really in the same market as out-of-State bonds, what
20 would be left of Commerce, of dormant Commerce Clause
21 jurisprudence if those arguments were accepted?

22 MR. TROWER: Well, all of the cases in which
23 the tax exemption or -- or other restrictive law favored
24 in-State private business would be left untouched. What
25 we're arguing for here is a rule that would apply only

1 to a transaction between the State itself and the
2 bondholder.

3 Market participation, contrary to my
4 brother's suggestion, does not end when the bonds are
5 issued any more than when you borrow money your
6 participation with your lender ends once the loan is --

7 JUSTICE KENNEDY: I think that's true.
8 There's a national securities market. Everybody knows
9 that.

10 MR. TROWER: Yes, sir.

11 JUSTICE KENNEDY: And I don't think either
12 side can avoid that fact. He's suggesting that it cuts
13 more in his favor than it does for yours because you are
14 creating artificial barriers to that market. So that
15 when a person who knows about Kentucky bonds and who
16 knows what the good ones are moves out of state, he all
17 of a sudden loses the advantage to purchase those bonds
18 anymore, or at least he does -- he takes a penalty for
19 doing that.

20 Let me -- let me ask you this, the question
21 I asked your co-counsel. A and D get together and agree
22 on reciprocal advantages for their -- for their
23 respective residents. Is that constitutional?

24 MR. TROWER: If it's approved by Congress,
25 yes, sir.

1 JUSTICE KENNEDY: Suppose it's not. And --

2 MR. TROWER: I think that --

3 JUSTICE KENNEDY: And isn't that exactly
4 what's happening here? Isn't that exactly what's
5 happening here? You have, in effect, a pact among
6 States to favor their own residents.

7 MR. TROWER: You could make that argument,
8 Justice Kennedy. But the -- the idea that what has
9 happened here is a race to the bottom is post hoc
10 reasoning extraordinaire. The Kentucky constitution was
11 enacted in 1890, 40 years before Kentucky had ever
12 enacted an income tax. The California constitution,
13 which also requires California to exempt its own bonds,
14 was enacted decades before California enacted an income
15 tax.

16 We would suggest that the record of history
17 is the States saw the opportunity to give their own
18 residents tax exemption as a way of finding a natural
19 market for their bonds, and they chose to do that and
20 that the fact that they chose to do that makes sense for
21 the States that did it. It also made sense for those
22 states that didn't choose to do that.

23 I would note that the seven states that --

24 JUSTICE KENNEDY: I suppose any favored
25 legislation favoring local industry helps the State, and

1 the State residents like it. That's the whole point.
2 That's why the Commerce Clause exists as a check.

3 MR. TROWER: Well, it's -- I wouldn't accept
4 that as the reason that the Commerce Clause exists as a
5 check.

6 But let's examine that analysis. Where is
7 the political check here? Well, we know how the other
8 States would vote because they support Kentucky. SIFMA,
9 which represents 90 percent of the bond trading --

10 JUSTICE KENNEDY: All politics is local.
11 All States want to protect their residents and make it
12 look like they're doing something for their residents.
13 And that's exactly the purpose of Commerce Clause
14 prohibition against explicit discrimination, which is
15 what this is. There's no doubt that this is explicit
16 discrimination.

17 MR. TROWER: There's no doubt that the law
18 on its face differentially treats two different kinds of
19 bonds or different bonds issued by different States.
20 We're not contending that at all. The question is, is
21 whether that different treatment is permissible? The
22 suggestion that the commerce --

23 JUSTICE SCALIA: Since we are talking here
24 about the negative Commerce Clause, we really should say
25 that's the reason the Commerce Clause doesn't exist.

1 (Laughter.)

2 MR. TROWER: That's right. That's exactly
3 right. And if we were -- if we were reading the -- the
4 negative Commerce Clause, I would call your attention to
5 the decisions in Reeves, which is exactly equivalent to
6 a home embargo, because it kept all the cement in South
7 Dakota; to the decisions in White and Alexandria Scrap,
8 which were exactly equivalent to a border blockade,
9 because they kept all the out-of-State workers from
10 working in Boston or at least up to the extent of 50
11 percent of the work forces; and under Alexandria Scrap
12 the effect of the legislation was to keep all of the
13 out-of-state towing companies from collecting the
14 bounties. And then in United Haulers, yes, it wasn't a
15 tax case, but that's a distinction without a difference,
16 because what United Haulers was equivalent to was a home
17 embargo.

18 And it's the home embargo, the border
19 blockade, and the discriminatory tariff or tax that are
20 always held up as the prototypes of things that our free
21 market prevents, as is the monopoly, which my brother
22 says is okay if a State monopolizes all the trade, but
23 it's not okay if a State still competes in the national
24 market in the issuance of bonds but yet offers a direct
25 financial incentive to its own taxpayers.

1 We come back to the effect of a tax
2 exemption of this type. It is exactly equivalent to the
3 payment of money by the State, because every dollar of
4 that tax exemption represents a detriment to the State.
5 The State is giving up revenue.

6 Now, you're right, Mr. Chief Justice, it may
7 be a wash at the end of the day, but that's a decision
8 that the Commerce Clause leaves to the States to make.
9 And your reference earlier to General Motors v. Tracy is
10 directly on point here, because there you had a
11 well-established, long-established market that the Court
12 was loath to jump in without any institutional
13 competence or information to evaluate the effects, where
14 Congress could take action if any was necessary.

15 What do we know about the historical record
16 here? We know Congress excruciatingly discussed, just
17 analyzed State tax and their effects on interstate
18 commerce and did nothing.

19 JUSTICE ALITO: Do you want us to -- do you
20 want us to hold that if Congress is, quote, unquote,
21 aware of some sort of discrimination that the States are
22 engaging in, that there is, therefore, no dormant
23 Commerce Clause problem?

24 MR. TROWER: No. That's not what we're
25 arguing for. We're not saying that what happened here

1 is equal to the kind of express approval of
2 discrimination, which the Court's precedents have
3 required.

4 What we're saying is where what we got is a
5 Congress that has studied this problem and done nothing,
6 with a Congress that has routinely approved interstate
7 compacts between the States that provide for
8 differential taxation of bonds, with a Congress that has
9 provided exemption from all tax for territory bonds,
10 Puerto Rico, Guam -- those are completely exempt per
11 acts of Congress, but Congress didn't go any further
12 than that, what is the conclusions for this Court to
13 draw? Does this Court rush in where Congress has failed
14 to tread? We think not.

15 JUSTICE ALITO: What is the difference
16 between that situation and the sort of flow control
17 ordinance that was involved in Carbone? Wasn't Congress
18 aware of those?

19 MR. TROWER: Yes. In fact, Congress had
20 authorized the kind of flow control ordinance that was
21 set up in Carbone. But as the -- as the Court decided
22 the Carbone case, the facility in Carbone, in the view
23 of the majority, was not a publicly owned facility. It
24 was a privately owned facility. If Carbone came up
25 again today, maybe a different analysis. But the

1 distinction between Carbone and United Haulers was
2 discussed at length in United Haulers, and the Court
3 found that a distinction --

4 JUSTICE ALITO: No, but why wasn't there the
5 same kind of congressional whatever it is, acquiescence,
6 in Carbone that you're claiming there was here?

7 MR. TROWER: I don't know that there wasn't
8 that same kind of congressional acquiescence. The
9 question is -- is what -- what is the Court to make of
10 that congressional acquiescence or congressional failure
11 to act? That's what we are arguing for here. We are
12 not saying Congress has sanctioned differential
13 taxation.

14 JUSTICE STEVENS: We are talking about not
15 just a dormant Commerce Clause, but a dormant Congress.

16 (Laughter.)

17 JUSTICE KENNEDY: What are -- what are
18 examples -- what are examples of Federal statutes that
19 have allowed explicit discrimination?

20 MR. TROWER: Prudential versus Benjamin. I
21 guess that's the insurance case, which of course we've
22 got --

23 JUSTICE KENNEDY: In the insurance industry?

24 MR. TROWER: Yes, sir, and that's obviously
25 huge as well. I think that's enough.

1 If there are no other questions, thank you.

2 CHIEF JUSTICE ROBERTS: Thank you,

3 Mr. Trower. The case is submitted.

4 (Whereupon, at 12:06 p.m., the case in the
5 above-entitled matter was submitted.)

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