

1 IN THE SUPREME COURT OF THE UNITED STATES

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3 DEPARTMENT OF REVENUE :

4 OF KENTUCKY, ET AL., :

5 Petitioners :

6 v. : No. 06-666

7 GEORGE W. DAVIS, ET UX. :

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9 Washington, D.C.

10 Monday, November 5, 2007

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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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P R O C E E D I N G S

(11:05 a.m.)

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

Mr. Trower.

ORAL ARGUMENT of C. CHRISTOPHER TROWER

ON BEHALF OF THE PETITIONERS

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

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

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

JUSTICE ALITO: Is what you just said true 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 points 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
14 tax-exempt borrowing power constitutionally? The answer
15 there is yes. Congress has already made that decision.

16 The second question is whether there's a
17 Commerce Clause problem if a State exempts its 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 -- in Carbone,
2 the facility, in fact, was not the -- the facility of
3 the -- of the government.

4 MR. TROWER: That's correct.

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

8 MR. TROWER: That's correct, but 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 -- was enabled to borrow at a
18 lower 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. But
5 don't you --

6 (Laughter.)

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

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

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

16 (Laughter.)

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

1 prevent?

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

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

11 MR. TROWER: That's exactly --

12 JUSTICE GINSBURG: -- in the lower courts.

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

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

1 tax on Missouri farmers who want to ship milk into
2 Kentucky. That's the classic unlawful -- all right.
3 It's unlawful, unconstitutional, right?

4 MR. TROWER: Yes, sir.

5 JUSTICE BREYER: All right. Now, what is
6 the difference if a city in Kentucky that wants to
7 finance its schools says now -- to the legislature --
8 we're going to find it easier to sell bonds in Kentucky
9 or elsewhere -- no, in Kentucky -- for our school system
10 if you'll only put a tax on similar bonds that Missouri
11 is offering to finance their city schools? That will
12 help, just like the milk. Now, what's the difference?

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

19 The second difference is that a tax on
20 out-of-State dairy products increases the cost of
21 out-of-State dairy products to in-State consumers with
22 no detriment to in-State dairy producers; whereas, as
23 our Respondents have pointed out in their brief --

24 JUSTICE BREYER: Yes. Right.

25 MR. TROWER: -- when a tax is imposed by a

1 government on a transaction where the government itself
2 is paying the money, which is what we have here, a tax
3 on interest income paid by the government, the effect is
4 to impose a dollar-for-dollar reduction in the
5 government's tax revenues equal to the amount of the
6 exemption. So you've got an in-State entity, namely,
7 the government itself, that is suffering a revenue loss.

8 That's not at all comparable to the dairy
9 hypothetical.

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

13 MR. TROWER: Yes, sir.

14 JUSTICE BREYER: And so they are suffering a
15 dollar-for-dollar loss, because their milk becomes more
16 expensive.

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

21 MR. TROWER: Yes, sir.

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

1 farms that are put up for, you know -- does it make a
2 difference?

3 MR. TROWER: I think it would make a
4 difference.

5 JUSTICE BREYER: It would make a difference.

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

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

22 Why isn't --

23 MR. TROWER: It's --

24 CHIEF JUSTICE ROBERTS: Why isn't that a
25 sufficient distinction from United Haulers?

1 MR. TROWER: The key distinction in the
2 United Haulers, Mr. Chief Justice, was between an entity
3 with the responsibility for the welfare of the citizens
4 within the jurisdiction versus all other entities. It
5 just happened to be in United Haulers that that was a
6 public entity versus private entities. But United
7 Haulers, we submit, would have reached exactly the same
8 result if the trash haulers had wanted to take the
9 garbage to a municipal or a public facility in New
10 Jersey, as opposed to a private facility in New Jersey.

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

19 The question I think that -- that Justice
20 Breyer brought up would also lead me to talk about what
21 are the purposes of the Commerce Clause writ large, or
22 the dormant Commerce Clause not writ large, that have
23 motivated this Court's jurisprudence? I think there are
24 three: Economic protectionism, which the Court has
25 repeatedly said does not apply to activity by the State

1 on its open behalf; secondly, the free market or free
2 trade rationale, which has motivated many of the Court's
3 decisions, but at the same time the Court has always
4 been careful to say that the free trade rationale, Maine
5 versus Taylor for example, does not value free trade
6 above all other values that we have. And we would
7 submit that the value here is the fundamental
8 sovereignty of the States.

9 Our political system subdivides
10 responsibility for government and responsibility for
11 public works in America. Bonds are not issued by the
12 States to make a profit or to leverage their return on
13 equity. Bonds aren't issued to create an investment
14 opportunity for Wall Street or for Main Street. Bonds
15 are issued to finance the essential work of government.
16 And this Court's decision should look at that part of
17 the equation as much more significant and weigh those
18 values much more heavily than the values of the free
19 market, which don't really apply to the State's
20 provision of goods and services. In all the dairy cases
21 --

22 JUSTICE KENNEDY: Suppose a State said that
23 it was unlawful for anyone other than a State resident
24 to purchase the bond?

25 MR. TROWER: That would be completely

1 constitutional.

2 JUSTICE STEVENS: What if -- what if the
3 State offered its taxpayers a higher interest rate than
4 purchasers from other States? Would that be
5 permissible?

6 MR. TROWER: Yes, sir, that would be totally
7 permissible and would achieve the same result as the
8 exemption that we've got here. So what you've got
9 before you is a --

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

16 MR. TROWER: I thought the question was if
17 the bonds increased the interest rate and limited the
18 purchasers to Kentucky citizens.

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

21 MR. TROWER: They could sell them to anyone
22 else, but the --

23 JUSTICE ALITO: Anyone who wasn't a Kentucky
24 citizen?

25 MR. TROWER: It would be -- let me back up.

1 I think I got ahead of myself there.

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

13 JUSTICE KENNEDY: Would it be constitutional
14 to say that the holder of the bond must always be a
15 Kentucky resident or, if you sold the bond, it has to be
16 -- sold the bond, it has to be to another Kentucky
17 resident?

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

23 CHIEF JUSTICE ROBERTS: Well, I suppose you
24 could achieve the same result simply by providing you're
25 not going to pay interest to somebody who is not a

1 Kentucky resident.

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

3 JUSTICE KENNEDY: So if New York has a very
4 strong financial community, it can really benefit its
5 citizens by keeping the market in New York bonds for
6 itself, if it chooses?

7 MR. TROWER: Yes, it could.

8 JUSTICE KENNEDY: And your case for that is,
9 what, United Haulers?

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

22 We don't have that friction here. All 49
23 States support Kentucky's position. Where that
24 political friction is not an issue, the need for
25 judicial invalidation of the laws of 42 States is

1 commensurately less.

2 On the other hand, what are the things that
3 we think that the Commerce Clause doesn't require --
4 doesn't require the States to do? It doesn't require
5 the States to give up incentives to local business
6 activities within the State. The Commerce Clause
7 doesn't throw into the -- the maw of the free market,
8 the --

9 JUSTICE STEVENS: How do you reconcile that
10 with the Bacchus case?

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

13 JUSTICE STEVENS: Correct.

14 MR. TROWER: -- with a tax.

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

18 MR. TROWER: That doesn't surprise me at
19 all, Justice Stevens, because your -- your concurring
20 opinion in Alexandria Scrap said the same thing. We
21 agree with that position.

22 CHIEF JUSTICE ROBERTS: So we have to
23 overrule Bacchus to agree with you?

24 (Laughter.)

25 MR. TROWER: No, sir. No, sir. The

1 suggestion that we're making here today is that a tax
2 exemption which applies directly and exclusively to the
3 payment of money by a government to its direct trading
4 partners is all you're dealing with here. That would
5 not change the result in Bacchus, Boston Stock Exchange,
6 or any of the other discriminatory tax cases because all
7 of those cases involved a -- a tax or an exemption.

8 CHIEF JUSTICE ROBERTS: Does your argument
9 depend upon the uses to which Kentucky is putting these
10 proceeds?

11 MR. TROWER: No, sir.

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

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

18 CHIEF JUSTICE ROBERTS: No. Just a public
19 facility.

20 MR. TROWER: It's -- yes, sir. It's
21 governmental.

22 CHIEF JUSTICE ROBERTS: So, if Kentucky had
23 a law that it could only -- no out-of-State car dealer
24 could sell cars in Kentucky, that benefited Kentucky car
25 dealers, and then it had a special tax on Kentucky car

1 dealers to fund local hospitals, airports, roads,
2 whatever -- that would be all right?

3 MR. TROWER: I don't think that would be all
4 right. I think that's the West Lynn Creamery case in
5 reverse.

6 CHIEF JUSTICE ROBERTS: So it doesn't
7 matter? So the use to which the proceeds are put
8 doesn't save an otherwise discriminatory activity?

9 MR. TROWER: The -- it is the -- it is the
10 entity which chooses the use to which the proceeds are
11 put that determines the Commerce Clause situation. The
12 choice of -- of sewers, airports, schools, that's up to
13 the -- to the governmental entity to make.

14 I'll reserve my time for rebuttal.

15 CHIEF JUSTICE ROBERTS: Thank you,
16 Mr. Trower.

17 Mr. Brunstad.

18 ORAL ARGUMENT OF G. ERIC BRUNSTAD, JR.

19 ON BEHALF OF THE RESPONDENTS

20 MR. BRUNSTAD: Mr. Chief Justice, and may it
21 please the Court:

22 This is a tax case and that makes a
23 difference. It's not a case about a monopoly, and
24 what's key about that is that Kentucky has not taken
25 over the national municipal bond market. It hasn't

1 taken over the market. It is trying to regulate the
2 market with this facially discriminatory tax. It is
3 facially discriminatory because on its face the statute
4 says if you buy in Kentucky an in-State bond, you have a
5 tax exemption. If you're in Kentucky and you buy the
6 out-of-State bond, we tax you. This is no different
7 from the Bacchus case or the Fulton case or Boston Stock
8 Exchange.

9 CHIEF JUSTICE ROBERTS: Or United Haulers.

10 MR. BRUNSTAD: It's very different, Your
11 Honor. Oh, no, it's very different, Mr. Chief Justice,
12 from United Haulers. There, inherent in the power to
13 take over -- the State took over the local
14 trash-handling market -- the power to create a monopoly
15 is the power to exclude all competition.

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

19 JUSTICE BREYER: And that, of course -- you
20 win as soon as we say that the commodity is the same as
21 milk. Obviously to me you would, but that's the issue.
22 And in United Haulers what the question was, I thought,
23 is if it is a traditional governmental function anyway
24 -- say, like producing electricity or cleaning the
25 streets -- there they discriminate and say you have to

1 buy in State. Well, it's different, and indeed it may
2 be okay.

3 So what you've just heard your brother --
4 brother argue is if this is a fortiori, because here
5 it's not even making electricity; it's not even
6 collecting trash; it is financing the most basically
7 governmental of all governmental institutions --
8 libraries, schools, streets.

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

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

21 JUSTICE BREYER: Can a State --

22 MR. BRUNSTAD: A standardized form of
23 securities, Your Honor.

24 JUSTICE BREYER: You're arguing the same --
25 but can a State do this? It produces a service or

1 product; it sells the service or product to in-State
2 people at a price 50 percent less than it sells to
3 out-of-State people.

4 MR. BRUNSTAD: Certainly, Your Honor. Under
5 the market participant doctrine, if -- if you want to
6 sell cement and you own the State-owned cement plant,
7 you can choose. You'll recall in South-Central --

8 JUSTICE BREYER: No, no. You're saying if
9 the State owns cement, it can sell 50 percent less to
10 its in-State citizens than out-of-State?

11 MR. BRUNSTAD: That's what this Court held
12 in Reeves versus Stake.

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

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

18 JUSTICE BREYER: All right. Suppose what
19 they're selling is education?

20 MR. BRUNSTAD: Well, I think --

21 JUSTICE BREYER: Can the University of
22 California say that when you send your child to the
23 University of California, you will get a thousand
24 dollars back on your income tax, but if you send the
25 child to an out-of-State school, you don't?

1 MR. BRUNSTAD: There the State is supplying
2 educational services to its citizens, and under the
3 market participant doctrine that would be fine. I think
4 this hypothetical --

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

8 MR. BRUNSTAD: But that's not what the tax
9 --

10 JUSTICE BREYER: And if you buy -- if you --
11 we sell you the participation. It's called a bond, and
12 if in fact you give the money to us, and you are
13 in-State, you get a thousand dollars back. But if in
14 fact, when you do the identical thing, and you buy a
15 similar thing from out-of-State, you do not get the
16 money back? How is that different from what you just
17 said was okay in respect to the University of
18 California?

19 MR. BRUNSTAD: Justice Breyer, that would be
20 a subsidy, and this Court drew the very distinction in
21 the New Energy case as the difference between a subsidy
22 and a tax. And that I think is absolutely critical.
23 And I think here Justice Holmes's admonition that "a
24 page of history is worth a volume of logic" makes sense.
25 The rallying cry for the American Revolution was not "no

1 subsidies without representation"; it was "no taxation
2 without representation."

3 JUSTICE BREYER: No, I'm sorry, then I
4 wasn't clear in the hypothetical. The hypothetical was
5 that you get a thousand-dollar rebate on your income
6 tax. So I was trying to make it exactly like this case.

7 MR. BRUNSTAD: Well, how --

8 JUSTICE BREYER: You pay a lower State tax.

9 MR. BRUNSTAD: But I think --

10 JUSTICE BREYER: And you --

11 MR. BRUNSTAD: I think there you would look
12 through the -- the form to the substance, and the
13 substance there is we would charge you X amount for
14 tuition and we're giving you part of that back as a
15 rebate. That is no different from a subsidy. Here it
16 is completely different, Your Honor.

17 JUSTICE GINSBURG: Why is it any different
18 from a tax credit?

19 MR. BRUNSTAD: Well, here, Your Honor, as
20 the Court made plain -- made plain in the Camps case,
21 Camps Newfound/Owatonna, a tax exemption is not the sort
22 of direct State involvement in the market that falls
23 within the market participation doctrine. There is a
24 key difference between a tax and a subsidy.

25 JUSTICE SOUTER: But in that case, the only

1 thing the State was doing was taxing. Here in Justice
2 Breyer's hypothetical, in the case that we've got, the
3 State is also participating in a bond market.

4 MR. BRUNSTAD: No, Your Honor, not in -- the
5 part that they're taxing is not their participation
6 part. I think a hypothetical will crystalize this.

7 JUSTICE SOUTER: Why do we draw that line?
8 I mean, you -- a moment ago you were talking about the
9 -- the realities of subsidy. Why don't you confront the
10 realities of -- of the fact that the State's
11 participation in the bond market and the -- and the tax
12 exemption go together hand in hand? It's unrealistic to
13 divide them.

14 MR. BRUNSTAD: Because, Justice Souter,
15 there is a fundamental difference between the two. A
16 tax tears down; a subsidy builds up. If you want to
17 subsidize your local park --

18 JUSTICE SOUTER: So what? The economic
19 reality is precisely the same.

20 MR. BRUNSTAD: But not constitutionally,
21 Justice Souter, and here's why --

22 JUSTICE SOUTER: Not constitutionally, we
23 have said in cases in which the State is acting purely
24 as the regulator. Here the State is not acting purely
25 as the regulator. The State has a dual capacity, and

1 you say ignore one side of that capacity for the other;
2 and my question is why?

3 MR. BRUNSTAD: Because, Justice Souter, here
4 what the State is taxing is the out-of-State commodity.
5 It is taxing -- it is doing a downstream regulation.
6 The State issues the commodity just like in
7 South-Central -- the State issued the timber; the State
8 owned the timber -- and then it imposed a downstream
9 regulation on the purchase --

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

13 MR. BRUNSTAD: But, Your Honor, it's no
14 different than the Boston Stock Exchange case, where
15 we're talking about the securities; or in Fulton, Your
16 Honor, shares of stock.

17 JUSTICE SOUTER: In which case the State was
18 not the participant that the State is here.

19 MR. BRUNSTAD: But the State here is using
20 its taxing power to regulate -- to regulate interstate
21 commerce; whereas, in United Haulers, Chief Justice
22 Roberts, there was no tax. There was no discriminatory
23 tax. And inherent in the power to create a monopoly is
24 the -- is the inherent power to preclude competition.
25 Here there is competition. It's economic gamesmanship,

1 Justice Souter. They want to sell their bonds
2 nationally but hoard their own investment dollars
3 locally, which is precisely --

4 CHIEF JUSTICE ROBERTS: So do you want to
5 suggest -- I'm sorry.

6 JUSTICE SOUTER: No. Please.

7 CHIEF JUSTICE ROBERTS: Are you suggesting
8 that the result in United Haulers would have been
9 different if there were a competing trash-processing
10 facility out-of-State?

11 MR. BRUNSTAD: No, Your Honor, because there
12 again we have a monopoly. The State took over the
13 entire market -- the trash-disposal facility, of
14 recycling and everything else, in the United Haulers
15 case. Inherent in the power to create a monopoly is the
16 power to exclude competition. There is no
17 discrimination by definition.

18 Here they have not taken over the market.
19 They are imposing a downstream regulation by taxing the
20 out-of-State commodity, and the distinction is
21 exactly --

22 CHIEF JUSTICE ROBERTS: Well, no, they're
23 not taxing the out-of-State commodity. Their tax is
24 imposed simply on Kentucky taxpayers.

25 MR. BRUNSTAD: I think, Chief Justice

1 Roberts, the -- the analysis that the Court made in the
2 New Energy case is directly on point and addresses this.
3 There the Court said, "The Commerce Clause does not
4 prohibit all State action designed to give its residents
5 an advantage in the marketplace, but only action of that
6 description in connection with the State's regulation of
7 interstate commerce." Direct subsidies "of domestic
8 industry does not ordinarily run afoul of that
9 prohibition; discriminatory taxation...does." Again --

10 JUSTICE SOUTER: And this situation is
11 somewhere in between the two. Because, although we do
12 not have what in form is a subsidy, we have what in
13 economic reality is a subsidy for the benefit of the
14 State's own activity as a bond issuer.

15 So the question again is, why do we accept
16 your characterization that this case should be treated
17 exactly as if the State were acting merely in a
18 regulatory capacity?

19 MR. BRUNSTAD: Because, Justice Souter, the
20 entire purpose of the dormant Commerce Clause
21 jurisprudence is to protect the integrity of the
22 markets. If Kentucky wants to have a subsidy and say
23 we're going to subsidize our own residents, fine. That
24 builds up something in Kentucky.

25 JUSTICE SOUTER: And the whole purpose of --

1 of the combined effect of market participant for the --
2 acting for the purpose of providing an essentially
3 governmental service is to give the State a free hand.
4 Why do we ignore that in your argument in favor simply
5 of the regulatory side?

6 MR. BRUNSTAD: Because, Justice Souter, what
7 they are doing here is imposing a facially
8 discriminatory tax. They have the burden of saying,
9 under the Court's precedents, they have no other
10 alternative.

11 JUSTICE SOUTER: But the question is whether
12 it will be treated as we treat a facially discriminatory
13 tax when there is no market participation, there is no
14 State participation for the purpose of providing a
15 fundamental governmental service? If -- if in fact
16 there is a good reason to treat them differently, then
17 we don't follow the -- the facial discrimination test.

18 Let me -- let me ask a -- a question with
19 that as the premise. Assuming -- and I obviously do
20 assume -- that we have a choice of analysis here, one
21 good reason to choose the analysis that your brother
22 has -- that the State is forwarding is the fact that we
23 have historically a bond market which has grown up since
24 New York issued the first tax-exempt or -- a bond.

25 MR. BRUNSTAD: In 1919, Your Honor.

1 JUSTICE SOUTER: And we -- we have an
2 enormous market, the effect of interrupting which we
3 really, as a Court, cannot tell very much. And that
4 seems to me a very good reason to give the nod to the --
5 to the market participant, the essential services side
6 of what the State is doing, as opposed to the regulatory
7 side, and simply confront the thing under Pike.

8 Why isn't that a good reason?

9 MR. BRUNSTAD: Because, Justice Souter, this
10 case represents a classic race to the bottom where the
11 only reason why we have these discriminatory tax laws is
12 because New York started it in 1919. It wanted to hoard
13 its own local investment dollars and yet sell its bonds
14 nationally.

15 Every other State caught on, and that
16 creates a problem in the marketplace which the dormant
17 Commerce Clause --

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

22 MR. BRUNSTAD: But a compact is precisely,
23 Your Honor, what the dormant Commerce Clause was
24 designed to prevent -- States coming together and trying
25 to create regional compacts or trying to create favored

1 trade deals among themselves.

2 JUSTICE BREYER: You know, I was only -- I
3 was only addressing your point that there was a
4 practical problem. Insofar as there's a practical
5 problem, it seems to me the States have a perfectly good
6 remedy even if they lose this case.

7 MR. BRUNSTAD: Even if they lose this case
8 --

9 JUSTICE BREYER: Or win the case, whatever.

10 MR. BRUNSTAD: But, Justice Breyer, the
11 whole point --

12 JUSTICE BREYER: However.

13 MR. BRUNSTAD: I think -- I think that the
14 Court's analysis in Quill is on point here. In the
15 Court's analysis in Quill, the Court said look, we have
16 this very clear rule that says States cannot engage in
17 facially discriminatory taxation. They can't do it.

18 And if, in fact, we're wrong -- if, in fact,
19 the Court's precedent creates a problem, then it's
20 something that Congress can easily fix. The States can
21 go to Congress.

22 CHIEF JUSTICE ROBERTS: But our approach in
23 the General Motors case was the exact opposite. There
24 we couldn't figure out whether the market for natural
25 gas was captive or not captive; it was a little of each.

1 And we kind of said, well, you know, if it's kind of a
2 close question, leave it for Congress because, after
3 all, the Commerce Clause talks about Congress's power.
4 The dormant Commerce Clause is not mentioned.

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

9 MR. BRUNSTAD: But, Chief Justice Roberts,
10 the same could have been said for the problem in
11 Granholm, where 26 States had the same
12 no-direct-shipment problem; or the same problem in
13 Bacchus, where 36 States had the same discriminatory
14 alcohol tax laws. Congress didn't --

15 CHIEF JUSTICE ROBERTS: It strikes me as
16 much more fundamental, whether or not a State can issue
17 a tax exemption for its -- its bonds. That seems more
18 fundamental than the more specialized issues in those
19 other cases.

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

23 MR. BRUNSTAD: But, Chief Justice Roberts,
24 Congress is -- is as unlikely to address this problem
25 now that it's so pervasive as it was to address the

1 problem in Granholm or the problem in Bacchus or any of
2 those other cases, or the problem in Fulton. Congress
3 has plenty of other things to do than --

4 JUSTICE BREYER: That argument cuts against
5 you in context, I think. You're saying, in every case
6 of any kind of discrimination, one could go to Congress.
7 Absolutely right.

8 And since that's true of every case, now
9 we're back to the more basic question, leaving the
10 practicalities that you were talking about out of it, of
11 whether this case is more like the cows? Is it more
12 like the garbage collection?

13 MR. BRUNSTAD: Correct.

14 JUSTICE BREYER: Or is it on the far side of
15 the garbage collection, even a stronger case for
16 permission under the Commerce Clause?

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

19 JUSTICE BREYER: That's where I wanted you
20 to begin.

21 (Laughter.)

22 MR. BRUNSTAD: But if you look at -- it is
23 -- it is, Chief -- Justice Breyer. If you look at
24 bonds, municipal bonds -- and we have some samples of an
25 Alabama bond and a Kentucky bond in the supplemental

1 appendix. These are standardized forms that are traded
2 as commodities like any other securities. They have the
3 same regulatory overlay, which is distinct from General
4 Motors versus Tracy, but --

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

7 MR. BRUNSTAD: That's true.

8 CHIEF JUSTICE ROBERTS: And the fact that
9 bonds are bonds doesn't seem to me to be very
10 responsive.

11 MR. BRUNSTAD: But the point -- two points,
12 Chief Justice Roberts: One is that in United Haulers we
13 did not have a tax on the out-of-State commodity coming
14 in. Here we do.

15 The second thing -- and I think this again
16 is critical -- we had a monopoly.

17 JUSTICE STEVENS: No, you didn't have a tax
18 on the out-of-State -- you have an income tax charged to
19 Kentucky residents on their income from that bond. It's
20 quite different.

21 MR. BRUNSTAD: But, Justice Stevens, that
22 points out how this is a downstream regulation. The
23 State's participation ends when it is done issuing the
24 bond. It goes to underwriters who then trade them in
25 the privately owned national bond market, no different

1 than in South-Central. The State of Alaska owned the
2 timber. It sold the timber in the marketplace. Then it
3 sought to impose this downstream regulation.

4 It would be the same as if New York City
5 said we have a local water company, and we have a
6 monopoly, and now we have someone who we are licensing,
7 a private business, to bottle that water to sell. And
8 we're slapping a tariff on Poland Springs from Maine,
9 because we want to protect the local business.

10 That's what's happening here. The State has
11 already issued the commodity. It is now in the
12 marketplace, and now they are basically prohibiting the
13 sale of it, or they are restricting the sale, by a
14 discriminatory, in essence, tariff.

15 If you live in Kentucky, we want to
16 discourage you from buying a Michigan bond. And they do
17 it by saying we will tax the interest on the -- on the
18 out-of-State bond, and not tax the interest on the
19 in-State bond. They are giving themselves a leg-up.

20 And one of the pernicious aspects of this is
21 it has the effect of pooling capital within the national
22 market. It has the effect of creating this
23 discriminatory barrier.

24 JUSTICE STEVENS: The victims under your
25 approach, as I understand it, are the 49 other States,

1 and all of them seem to support your opponent in the
2 briefs they've filed in this case.

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

8 My clients, the Davises, are penalized
9 because they are engaging in interstate commerce. They
10 are penalized. Because they own out-of-State bonds,
11 they pay a tax.

12 CHIEF JUSTICE ROBERTS: Your argument that
13 you just presented in response to Justice Stevens's
14 question, I think, relies on the discrimination against
15 the out-of-State issuers.

16 MR. BRUNSTAD: Correct.

17 CHIEF JUSTICE ROBERTS: Your clients are not
18 out-of-State issuers.

19 MR. BRUNSTAD: That's true.

20 CHIEF JUSTICE ROBERTS: We don't have an
21 overbreadth doctrine under the Commerce Clause. Why
22 aren't their arguments limited to discrimination against
23 them rather than discrimination against out-of-State
24 issuers?

25 MR. BRUNSTAD: Well, for the same reason

1 that it wouldn't be limited with the -- the taxpayer in
2 Fulton or the in-State taxpayer in Bacchus, where they
3 are basically arguing that this affects interstate
4 commerce. And, as illustrative of that, we're saying
5 look, in Bacchus you had the local brandy, and the local
6 pineapple wine got a tax break.

7 CHIEF JUSTICE ROBERTS: So your Kentucky
8 taxpayers can argue about the discrimination against
9 out-of-State bond issuers?

10 MR. BRUNSTAD: They can argue about the
11 discriminatory effects of this law on the marketplace as
12 a whole, because they are participants in the market.
13 They are penalized for engaging in interstate commerce,
14 the same way that all of the same arguments were
15 presented in the Bacchus case with an in-State taxpayer,
16 the Fulton case with an in-State taxpayer.

17 And the Court has basically made that plain
18 in the New Energy case. You don't have to demonstrate
19 that there is some overwhelming, you know, "the sky is
20 falling" problem. Any discrimination on -- with respect
21 to interstate commerce, any discriminatory effect
22 basically --

23 CHIEF JUSTICE ROBERTS: How do we know that
24 your -- your clients will be better off regardless of
25 how this case is resolved? One way to resolve it, of

1 course, would be to take away the Kentucky tax
2 exemption, which would hurt your clients.

3 Another way to resolve it would be to extend
4 the tax exemption to the Ohio bonds, which may hurt your
5 clients if the Kentucky bonds aren't competitive, and
6 the price of the Kentucky bonds goes down. They would
7 lose either way.

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

11 Now, in Kentucky there is a constitutional
12 provision which says they cannot -- they basically
13 cannot have their own bonds other than tax-exempt.

14 So unless they change their constitution,
15 the result would be to make all the bonds, municipal
16 bonds, tax-exempt in Kentucky, which, of course, would
17 benefit my clients, who hold out-of-State municipal
18 bonds. But consider this --

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

22 In other words, their advantage now comes
23 from the tax exemption for Kentucky bonds; and it's not
24 clear, if that is eliminated across the board, that
25 Kentucky bonds are going to be competitive with, you

1 know, bonds of whatever other State. So the value of
2 them may go down, and your clients may lose, whether you
3 win or not.

4 MR. BRUNSTAD: But, Chief Justice Roberts,
5 consider these two critical points:

6 One cardinal principle of investment is
7 diversification. These discriminatory tax laws
8 basically compel people to hold only the bonds within
9 their particular State. The prospectuses for these
10 single-State bond funds say: Warning -- not diverse.
11 The second thing is their higher cost.

12 CHIEF JUSTICE ROBERTS: I mean it -- it
13 provides an advantage depending upon the level of the
14 State income tax and, I suppose, the level of the -- the
15 exemption. It doesn't necessarily mean that that's the
16 only bonds they're going to -- going to hold.

17 MR. BRUNSTAD: But that simply means that if
18 the State is -- has a very high income tax, say, in
19 California, that's all the more reason, all the more
20 penalty, for people who want to engage in interstate
21 commerce and diversify their portfolios.

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

25 MR. BRUNSTAD: Kentucky has a lower income

1 tax, but I think on the -- on the problem that was
2 raised, what if we -- if we affirm in this case, what
3 would the impact be?

4 Well, the State of Kentucky has said,
5 itself, that if it has to pay out refunds, we're talking
6 about a \$4 million per year refund obligation the State
7 of Kentucky has said it will have to pay.

8 The sky is not going to fall. What would
9 happen is that bond prices might adjust, but we would
10 have the free national market with interstate trade and
11 municipal bonds unimpaired by these artificial
12 constraints. These artificial discriminatory tax
13 regimes create artificial demand. They pool assets.
14 They hoard assets, local investment dollars, within
15 particular States. And you have a problem where, say,
16 cash-scarce States like, for example, Tennessee have
17 more of a restricted access to capital markets like New
18 York. If you're an investor in New York and you have
19 money to spend in municipal bonds, you are discouraged
20 from buying Tennessee bonds; you're encouraged from
21 buying New York State municipal bonds. The cash --
22 relatively capital-scarce States are harmed. Again,
23 people like the Davises, they are harmed. They are
24 penalized from engaging in interstate commerce.

25 JUSTICE KENNEDY: I can ask your brother,

1 who represents Petitioner -- maybe I'd better should --
2 I'd get a better answer from him so far as his position.

3 As you understand his position, as you
4 understand the State's position, would it be permissible
5 for State A to go to State B and say: If you make your
6 bonds nontaxable to our residents, we'll make your bonds
7 nontaxable to your residents.

8 MR. BRUNSTAD: We actually have that,
9 Justice Kennedy. Ohio, when it enacted its
10 discriminatory tax scheme here similar to Kentucky's, it
11 basically said: We will tax the bonds of an
12 out-of-State State, unless they do not tax Utah bonds.
13 So -- but you can see that clearly illustrates, to me --

14 JUSTICE KENNEDY: Do you find that
15 consistent with the vision of the Framers for our
16 national market under the Commerce Clause?

17 MR. BRUNSTAD: Inconsistent, Justice
18 Kennedy. Inconsistent. This is nothing more than an
19 ongoing low-level trade war. It was started by New York
20 in 1919, when it basically created this discriminatory
21 tax scheme for itself. It basically incentivizes all
22 the States to follow suit. And it's easy to understand
23 why.

24 JUSTICE GINSBURG: What about the example
25 that was given of an interstate compact, say, to operate

1 a port authority that covers a few States, and the
2 compacters agree that they are not going to tax the
3 income on bonds issued by the port authority, but they
4 are going to tax the income from out-of-State municipal,
5 but it's only the bonds from this port authority. So
6 they -- it seems your theory would reach that too.

7 MR. BRUNSTAD: It would, Justice Ginsburg.

8 JUSTICE GINSBURG: And yet Congress has
9 approved compacts that say just that.

10 MR. BRUNSTAD: But where Congress
11 specifically speaks to permitting a particular practice,
12 then it can't violate the dormant Commerce Clause. Here
13 Congress has not spoken. The States are doing this on
14 their own.

15 And, Justice Kennedy, again, it is
16 completely inconsistent with the vision of the Framers
17 because what's happening here, again, is the race to the
18 bottom, where New York said: All right, we're going to
19 sell our bonds nationally; ah, but we're going to create
20 an investment for all the capital in New York to stay in
21 New York.

22 And you can see why every other State
23 afterwards said: Oh, look what New York is doing. We
24 have to follow suit to try to equal the playing field.
25 And, again, that is at the heart of the ongoing

1 low-level trade war with the --

2 CHIEF JUSTICE ROBERTS: Well, it assumes
3 it's all in the definition of your market. If your
4 market is tax-exempt bonds nationwide, it's one thing;
5 but your brother says the market ought to be people who
6 issue bonds for public works in Kentucky, and Kentucky
7 is the only one who does that. So there's no
8 discrimination against anyone else because nobody else
9 is similarly situated to Kentucky with respect to
10 Kentucky public works.

11 MR. BRUNSTAD: But, Chief Justice Roberts,
12 here it's easy to tell what the market is. Kentucky
13 municipal bonds, in spite of the tax discrimination,
14 sell in a national, single market. There's a national,
15 Federal overlay. Under Federal income tax purposes,
16 they're all tax exempt. They're all regulated under the
17 same Federal securities laws. The fraud parts of the
18 securities laws apply. They all compete for each other.
19 It's the fact that they compete for each other.

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

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

1 JUSTICE STEVENS: Does it -- do we have it
2 for any State?

3 MR. BRUNSTAD: No, we do not, Justice
4 Stevens. We do not.

5 CHIEF JUSTICE ROBERTS: Well, I thought it
6 was inherent in your argument that most of them -- I
7 mean, if you're talking about hoarding capital, it
8 doesn't work very well if a lot of people outside
9 Kentucky are buying these bonds. There's not much
10 Balkanization if they're circulated widely. I thought
11 that your argument depended on the proposition that most
12 of these bonds are bought by Kentucky residents.

13 MR. BRUNSTAD: There is Balkanization, but
14 it's not complete Balkanization, just like the tax in --
15 that Hawaii imposed on the alcohol didn't prevent the
16 sale of fine California chardonnay imported into Hawaii;
17 it just promoted the sale of the locally produced wine.
18 It doesn't have to be a complete ban, as this Court
19 explained in Limbach, a complete ban or a discrimination
20 that imposes a burden. There's no constitutional
21 difference.

22 And that applies here too, but the market
23 criteria the Court -- the Court applied in GMC versus
24 Tracy, I think, applies here. You don't look to define
25 the market by, gee, what's going to happen or what's the

1 purpose of the particular discrimination? You look at
2 ordinary commercial factors. And here the ordinary
3 commercial factors are there is one national market in
4 which these standardized commodities trade. They're
5 issued by the State. They're owned by individuals.
6 Kentucky doesn't own the bonds. Kentucky issues them.
7 They are then traded in the national market.

8 JUSTICE STEVENS: But they're not really
9 standardized. It seems to me, even without a tax
10 exemption, residents of Kentucky would be interested in
11 public improvements in Kentucky and have -- give a
12 slight edge in the market to all Kentucky bonds. I
13 think there would be just a natural preference for
14 locally issued bonds.

15 MR. BRUNSTAD: And if they choose to do
16 that, that's fine.

17 JUSTICE STEVENS: But they're not totally
18 fungible.

19 MR. BRUNSTAD: And, of course, that would
20 not be prevented by having nondiscriminatory taxes.

21 JUSTICE STEVENS: No, but it's a fact of the
22 market, it seems to me, that Kentucky bonds are
23 characteristically more attractive to Kentucky citizens
24 than they are to out-of-State citizens.

25 MR. BRUNSTAD: But, Justice Stevens, I think

1 that's an idiosyncratic value, not shared. Most
2 investors care about yield and --

3 JUSTICE KENNEDY: I assume there would be a
4 preference to Massachusetts milk for Massachusetts
5 buyers, to Michigan automobiles to Michigan buyers, and
6 that the State could not subsidize.

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

9 JUSTICE KENNEDY: -- place of origin.

10 MR. BRUNSTAD: Justice Kennedy, that strikes
11 me as the argument that Japan made when it said: We
12 should keep American-made skis out of the Japanese
13 market because Japanese snow is different from American
14 snow. I mean you can't use those kinds of
15 justifications to say --

16 CHIEF JUSTICE ROBERTS: Well, that's not
17 fair because Kentucky is going to use the proceeds of
18 the bonds to build a hospital, a school that is going to
19 serve Kentucky residents.

20 MR. BRUNSTAD: But --

21 CHIEF JUSTICE ROBERTS: So there's -- it's
22 not just emotional attachment to Kentucky that would
23 promote the purchase of those bonds by Kentucky
24 residents. It's self-interest. They want a public
25 hospital nearby, and -- and, therefore, it makes sense

1 to buy the hospital bonds.

2 MR. BRUNSTAD: But, Chief Justice Roberts,
3 every tax serves a public purpose. Every tax is for the
4 State's purposes. If this Court opens the door in this
5 case to say that this facially discriminatory tax regime
6 is okay, this Court will open the door to all of the
7 discriminatory taxes the Court has heretofore struck
8 down. This case -- this Court's discriminatory tax
9 precedents --

10 CHIEF JUSTICE ROBERTS: There's a very --
11 there's a very big difference between -- and it gets to
12 the difference with the Wisconsin cows, which was
13 addressed in United Haulers. That's a tax on private
14 activity, and private actors don't have the
15 responsibility of providing government services.
16 Kentucky does.

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

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

25 (Laughter.)

1 MR. BRUNSTAD: But the -- this Court's
2 dormant Commerce Clause precedents are directed to
3 preserving the integrity of markets. Once you stray and
4 you do not have those clear lines between monopolies --
5 United Haulers -- discriminatory taxes, and subsidies,
6 then I think you make -- you take what is a very clear
7 monument of economic freedom, this idea of no
8 discriminatory taxes, certainly not discriminatory taxes
9 on their face, and you blur those distinctions and you
10 pull down this monument the Court has.

11 As the Court -- for the reasons the Court
12 said in *Quill*, these distinctions are important. If
13 Congress, in this particular area, does not like the
14 result, it can change the result. But,
15 jurisprudentially, we need to maintain a distinction
16 between subsidies, between monopolies, and between
17 taxes. Again --

18 JUSTICE GINSBURG: When the Court -- in that
19 old *Bonaparte* case, it was just kind of very naive
20 because the Court made a decision that didn't -- that
21 State A can't create bonds that are going to be exempt
22 from tax in other States, right?

23 MR. BRUNSTAD: Not quite, Justice Ginsburg.
24 That was a full-faith-and-credit case in which the
25 Maryland resident said: Oh, I own out-of-State bonds;

1 therefore Maryland can't tax me because the out-of-State
2 State wouldn't tax me if I lived there. A completely
3 different issue, Your Honor. This issue was not before
4 the Court in Bonaparte.

5 Thank you.

6 CHIEF JUSTICE ROBERTS: Thank you,
7 Mr. Brunstad.

8 Mr. Trower, you have 12 minutes remaining.

9 REBUTTAL ARGUMENT OF C. CHRISTOPHER TROWER
10 ON BEHALF OF THE PETITIONERS

11 MR. TROWER: Let's start with the idea that
12 the Kentucky tax penalizes Respondents for participating
13 in interstate commerce. The answer there is no. The
14 Kentucky tax affords a direct trading partner, that is
15 to say, a person that owns Kentucky bonds, a quid pro
16 quo. If a Kentucky taxpayer loans money to Kentucky,
17 Kentucky gives a tax exemption to that person that loans
18 money to Kentucky. If a Kentucky resident chooses to
19 loan money to California by buying California bonds, no
20 tax exemption is afforded.

21 But that different treatment is not a
22 penalty, we would submit, but rather a recognition that
23 the Kentucky resident who loans money to Kentucky is
24 entitled to receive something in return.

25 CHIEF JUSTICE ROBERTS: Well, why do you

1 care, Mr. Trower? I mean, if you lose your tax
2 exemption, it means you've got to pay more interest to
3 sell your bonds, but it also means you're going to get
4 taxes that you don't get now. Isn't it kind of a wash?
5 Does it really matter?

6 MR. TROWER: It matters tremendously, Your
7 Honor. Seventy-five percent of all municipal bonds
8 issued in America are issued by municipalities, local
9 agencies, and those bonds -- under \$10 million in
10 principal amount -- those bonds account for only 7
11 percent of the total volume of bonds outstanding. We
12 pointed -- the citations for this are in our reply
13 brief.

14 The significance would be that many
15 municipalities might have no market access at all for
16 their bonds. An investor could ignore 75 percent of all
17 bonds that are issued.

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

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

1 JUSTICE ALITO: It seems to me you're making
2 a lot of arguments that, if accepted, would -- maybe
3 this isn't true of all of your arguments, but certainly
4 many of them would demonstrate that Commerce Clause
5 jurisprudence is utterly incoherent. If -- if taxation
6 is the same thing as a -- as a subsidy, if congressional
7 inaction is the same thing as approval, if Kentucky
8 bonds are not really in the same market as out-of-State
9 bonds, what would be left of Commerce -- of dormant
10 Commerce Clause jurisprudence if those arguments were
11 accepted?

12 MR. TROWER: Well, all of the cases in which
13 the tax exemption or -- or other restrictive law favored
14 in-State private business would be left untouched. What
15 we're arguing for here is a rule that would apply only
16 to a transaction between the State itself and the
17 bondholder.

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

22 JUSTICE KENNEDY: I think that's true. I
23 mean there's -- there's a national securities market.
24 Everybody knows that.

25 MR. TROWER: Yes, sir.

1 JUSTICE KENNEDY: And I don't think either
2 of -- either side can avoid that fact. He's suggesting
3 that it cuts more in his favor than it does for yours
4 because you are creating artificial barriers to that
5 market. So that when a person who knows about Kentucky
6 bonds and who knows what the good ones are moves out of
7 state, he all of a sudden loses the advantage to -- to
8 purchase those bonds anymore, or at least he does -- he
9 pays a penalty for doing that.

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

14 MR. TROWER: If it's approved by Congress,
15 yes, sir.

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

17 MR. TROWER: I think that --

18 JUSTICE KENNEDY: And isn't that exactly
19 what's happening here? Isn't that exactly what's
20 happening here? You have, in effect, a pact among
21 States to favor their own residents.

22 MR. TROWER: You could make that argument,
23 Justice Kennedy. But the -- the idea that what has
24 happened here is a race to the bottom is post hoc
25 reasoning extraordinaire. The Kentucky constitution was

1 enacted in 1890, 40 years before Kentucky ever enacted
2 an income tax. The California constitution, which also
3 requires California to exempt its own bonds, was enacted
4 decades before California enacted an income tax.

5 We would suggest that the record of history
6 is that the States saw the opportunity to give their own
7 residents tax exemption as a way of finding a natural
8 market for their bonds, and they chose to do that. And
9 that -- and that the fact that they chose to do that
10 made -- made sense for the States that did it. It also
11 made sense for those states that didn't choose to do
12 that.

13 I would note that the seven States that --

14 JUSTICE KENNEDY: I suppose any -- any
15 favored legislation favoring local industry helps the
16 State, and the State residents like it. That's the
17 whole point. That's why the Commerce Clause exists as a
18 check.

19 MR. TROWER: Well, it's -- I wouldn't accept
20 that as the reason that the Commerce Clause exists, as a
21 check.

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

1 JUSTICE KENNEDY: All politics is local.
2 All States want to protect their residents and make it
3 look like they're doing something for their residents.
4 And that's exactly the purpose of the -- of the Commerce
5 Clause prohibition against explicit discrimination,
6 which is what this is. There's no doubt that this is
7 explicit discrimination.

8 MR. TROWER: There's no doubt that the law
9 on its face differentially treats two different kinds of
10 bonds or different bonds issued by different States.
11 We're not contending that at all. The question is, is
12 whether that different treatment is permissible? The
13 suggestion that the Commerce --

14 JUSTICE SCALIA: Since we're talking here
15 about the negative Commerce Clause, we really should say
16 that's the reason the Commerce Clause doesn't exist.

17 (Laughter.)

18 MR. TROWER: That's right. That's exactly
19 right. And if we were -- if we were reading the -- the
20 negative Commerce Clause, I would call your attention to
21 the decisions in Reeves, which is exactly equivalent to
22 a home embargo, because it kept all the cement in South
23 Dakota; to the decisions in White and Alexandria Scrap,
24 which were exactly equivalent to a border blockade,
25 because they kept all the out-of-State workers from

1 working in Boston or at least up to the extent of 50
2 percent of the workforces; and under Alexandria Scrap,
3 the effect of the legislation was to keep all of the
4 out-of-State towing companies from collecting the
5 bounties. And then in United Haulers, yes, it wasn't a
6 tax case, but that's a distinction without a difference,
7 because what United Haulers was equivalent to was a home
8 embargo.

9 And it's the home embargo, the border
10 blockade, and the discriminatory tariff or tax that are
11 always held up as the prototypes of things that our free
12 market prevents, as is the monopoly, which my brother
13 says is okay if a State monopolizes all the trade, but
14 it's not okay if a State still competes in the national
15 market in the issuance of bonds, but yet offers a direct
16 financial incentive to its own taxpayers.

17 We come back to the effect of a tax
18 exemption of this type. It is exactly equivalent to the
19 payment of money by the State, because every dollar of
20 that tax exemption represents a detriment to the State.
21 The State is giving up revenue.

22 Now, you're right, Mr. Chief Justice, it may
23 be a wash at the end of the day, but that's a decision
24 that the Commerce Clause leaves to the States to make.
25 And your reference earlier to General Motors versus

1 Tracy is directly on point here, because there you had a
2 well-established, long-established market that the Court
3 was loath to jump in without any institutional
4 competence or information to evaluate the effects, where
5 Congress could take action if any was necessary.

6 What do we know about the historical record
7 here? We know Congress excruciatingly discussed, just
8 analyzed State tax and their effects on interstate
9 commerce, and did nothing.

10 JUSTICE ALITO: Do you want us to -- do you
11 want us to hold that if Congress is, quote, unquote,
12 "aware" of some sort of discrimination that the States
13 are engaging in, that there is, therefore, no dormant
14 Commerce Clause problem?

15 MR. TROWER: No. That's not what we're
16 arguing for. We're not saying that what happened here
17 is equal to the kind of express approval of
18 discrimination with the -- which the Court's precedents
19 have required.

20 What we're saying is where what we've got is
21 a Congress that has studied this problem and done
22 nothing, with a Congress that has routinely approved
23 interstate compacts between the States that provide for
24 differential taxation of bonds, with a Congress that has
25 provided exemption from all tax for territory bonds,

1 Puerto Rico, Guam -- those are completely exempt per
2 acts of Congress -- but Congress didn't go any further
3 than that, what is the conclusions for this Court to
4 draw? Does this Court rush in where Congress has failed
5 to tread? We think not.

6 JUSTICE ALITO: Well, what is the difference
7 between that situation and the sort of flow control
8 ordinance that was involved in Carbone? Wasn't Congress
9 aware of those?

10 MR. TROWER: Yes. In fact, Congress had --
11 had authorized the kind of flow control ordinance that
12 was set up in Carbone. But as the -- as the Court
13 decided the Carbone case, the facility in Carbone, in
14 the view of the majority, was not a publicly owned
15 facility. It was a privately owned facility. If
16 Carbone came up again today, maybe a different analysis.
17 But the -- the distinction between Carbone and United
18 Haulers was discussed at length in United Haulers, and
19 the Court found that distinction --

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

23 MR. TROWER: I don't know that there wasn't
24 that same kind of congressional acquiescence. The
25 question is -- is what -- what is the Court to make of

1 that congressional acquiescence or congressional failure
2 to act? That's what we're arguing for here. We're not
3 saying Congress has sanctioned differential taxation.

4 JUSTICE STEVENS: You're talking about not
5 just a dormant Commerce Clause, but a dormant Congress.

6 (Laughter.)

7 JUSTICE KENNEDY: What are -- what are
8 examples -- what are examples of Federal statutes that
9 have allowed explicit discrimination?

10 MR. TROWER: Prudential versus Benjamin. I
11 guess that's the insurance case, which, of course, we've
12 got --

13 JUSTICE KENNEDY: In the insurance industry?

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

16 If there are no other questions, thank you.

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

19 The case is submitted.

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

22

23

24

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