No. 21-1066

IN THE

Supreme Court of the United States

WASHINGTON BANKERS ASSOCIATION,
a Washington Public Benefit Corporation, and
AMERICAN BANKERS ASSOCIATION,
a District of Columbia Non-Profit Corporation,
Petitioners,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE OF THE STATE OF WASHINGTON, and VIKKI SMITH,
as Director of the Department of Revenue of the State of Washington,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF WASHINGTON

REPLY BRIEF

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INTRODUCTION

Washington State enacted a massive surtax that, although cast in ostensibly neutral terms, is triggered by affiliation with entities that engage in extensive interstate commerce—and that falls overwhelmingly on out-of-state businesses, and exclusively on members of large national networks. The undisputed trial-court record shows that the law has operated as intended: 98% of financial institutions subject to the surtax have their principal places of business outside Washington State, 99.74% of surtax revenue is paid by entities based out of state, and 100% of those paying the surtax are liable only because they are affiliated with interstate banking networks. Pet. 2, 7. Even Respondents' (collectively, "Washington") inappropriate effort to submit new evidence (*see* BIO App.) doesn't purport to dispute these last two, incredibly telling, facts.

Washington instead emphasizes that the surtax does not *expressly* favor local over interstate interests. The Washington Supreme Court made that same mistake, thereby running afoul of this Court's precedents and deepening acknowledged divisions about when laws that are triggered by proxies for interstate commerce violate the Commerce Clause. Washington argues that those divisions are merely the result of factual differences among cases but ignores the divisions among those courts on this critical question of law. And, as multiple amici explain, accepting Washington's reasoning would pave the way for other states to evade the Commerce Clause by clothing discriminatory standards in facially neutral garb and

achieving a time-honored, but unconstitutional, goal: funding state budgets on the backs of out-of-staters.

Much of the rest of the Brief in Opposition turns on a misplaced view of tax exceptionalism. Washington argues that a tax that is "apportioned"—i.e., includes only in-state income in the tax *base*—cannot violate the Commerce Clause. But this Court has held otherwise. Pet. 26-27. And the discriminatory mechanism here is not the tax base, but the higher tax *rate* (nearly double), which is triggered when a group affiliated with the taxpayer earns a $1 billion profit anywhere in the world. That is, the tax targets interstate commerce for disfavored treatment. Elsewhere, Washington tries to reframe this case as a referendum on graduated tax rates. But nothing about this case calls into question garden-variety graduated tax rates, and nothing about the Washington Supreme Court's reasoning is limited to the tax context. On the contrary, this case raises a core question concerning the Commerce Clause about which numerous courts are badly and expressly divided. The Court should grant review.

ARGUMENT

I. The Lower Courts Are Divided Over The Constitutionality Of Laws That Discriminate On The Basis Of A Proxy For Interstate Commerce.

A. As the Petition details, there is deep and acknowledged division in the lower courts about whether and when laws that impose disfavored treatment on out-of-state businesses based on a proxy for

interstate commerce impermissibly discriminate against interstate commerce. Pet. 10-19, 24-25, 27-28.

Washington principally dismisses this division as the product of "different facts and different regulatory regimes." BIO 25; *see* BIO 33-34. But that can be said about almost any case implicating any circuit split. On that reasoning, the Court should not have granted certiorari on the Commerce Clause issue in *National Pork Producers Council v. Ross* (No. 21-468) because there is no circuit conflict about the constitutionality of pig-rearing statutes. Yet the Court often reviews laws with "unusual feature[s]" that nonetheless implicate fundamental Commerce Clause principles. *Comptroller of Treas. of Maryland v. Wynne*, 575 U.S. 542, 545 (2015). Here, likewise, regardless of whether lower courts have divided on the narrow question of the constitutionality of "apportioned taxes based on profit," BIO 25, review is warranted to address the broader, critical question of whether an otherwise discriminatory law is immune from Commerce Clause scrutiny because it classifies based on stand-ins for interstate commerce.[1]

Washington's claim that we "manufacture[d]" the conflict over discrimination by proxy, BIO 24, is refuted by the courts themselves, which are in

[1] If the Court does not grant this petition, it may hold it pending the resolution of *Pork Producers*. That case implicates whether a statute is immune from Commerce Clause scrutiny if it directly regulates only in-state activity, regardless of its effect on interstate commerce. *See* Pet. 15, *Pork Producers* (No. 21-468). Washington's apportionment argument assumes the answer, and in adopting it, the Washington Supreme Court deepened division on that score. *See* Pet. 27-28.

conversation—and open disagreement—with each other. The Seventh Circuit has specifically relied on the Eleventh Circuit's cases to find discrimination by proxy. Pet. 13. On the other side, the Ninth Circuit recognized that those Eleventh Circuit cases are "at odds with" other circuit cases with which it aligned itself. *Int'l Fran. Ass'n, Inc. v. City of Seattle*, 803 F.3d 389, 404 n.7 (9th Cir. 2015); *see* Pet. 16-17. It did not merely "acknowledge[]" those cases and distinguish them factually, BIO 32; it candidly admitted that it is "difficult to reconcile" decisions addressing measures that "impose[] costs on a class of businesses said to be highly correlated with out-of-state firms or interstate commerce," 803 F.3d at 403-04 (quotation marks and citation omitted).

B. Ignoring this explicit acknowledgment of conflict, Washington tries to chip away at the cases by distinguishing them factually. As the Petition explains, at least five courts of appeals recognize that discrimination by proxy violates the dormant Commerce Clause. Pet. 11-15.

Washington tries to distinguish the First, Sixth, and Eleventh Circuits' cases from this case on the grounds that they involve "[1] *regulatory* distinctions that are alleged to [2] prohibit or substantially limit competition in a local market." BIO 25 (emphasis added); *see* BIO 24-28. But Washington is wrong that "regulatory" laws are categorically different from taxes and that "this Court has established an entirely distinct body of law addressing constitutional challenges to taxes." BIO 34. On the contrary, in tax cases this Court often relies on cases assessing non-tax

regulations. *E.g.*, *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984).

As to whether competition must be *prohibited*, that question itself is the subject of lower-court conflict, a point the Petition raised (at 24-25) and Washington ignores. That division persists—and was deepened by the decision below—notwithstanding precedent making plain that a complete prohibition on competition is sufficient but not necessary to establish a constitutional violation. Pet. 24. The cases with statutes that "substantially limit[ed] competition," BIO 25, aren't distinguishable either; nearly doubling the tax rate on certain businesses does just that. The Washington surtax limits competition because it lowers taxpayers' profitability, impacting "pricing, investment and other business decisions." CP 298-309 (bank declarations); *see* Chamber of Commerce Br. 13-18.

Washington also seeks (at 28-29) to distinguish the Seventh and Eighth Circuit cases discussed in the Petition (at 12-14). Washington argues that *Wiesmueller v. Kosobucki*, 571 F.3d 699 (7th Cir. 2009), is irrelevant because the claim there was merely allowed to proceed. But the *reason* the claim went forward is that, unlike the Washington Supreme Court, the Seventh Circuit held that the complaint sufficiently alleged discrimination even though the classification (the diploma privilege) was not expressly cast in terms of state residency. *Id.* at 704-05. The same is true of the farming initiative in *Jones v. Gale*, 470 F.3d 1261 (8th Cir. 2006). True, the court labeled the law "facially discriminatory," *id.* at 1267, but the court was not using that term in the way

Washington does—to denote a law that expressly "draws ... distinction[s] between in-state and out-of-state businesses," BIO 6. After all, that law "d[id] not expressly prohibit the owning of agricultural land by out-of-state citizens and d[id] not exclude solely out-of-state corporations." 470 F.3d at 1267.

C. Finally, Washington tries to explain away the other side of the split, i.e., cases that didn't find discrimination by proxy. *Compare* Pet. 16-18, *with* BIO 29-34. Of course those courts didn't come out and "say" they are "allow[ing] ... authorities to use proxies for interstate commerce to disadvantage out-of-state interests," BIO 29, but that is exactly what they did. In *Wal-Mart Stores, Inc. v. Texas Alcoholic Beverage Commission*, 945 F.3d 206 (5th Cir. 2019), the Fifth Circuit did just that when it permitted the state to prohibit public corporations from obtaining liquor permits, because (it said) the law was facially neutral and did not prevent all out-of-state businesses from obtaining permits. That ruling is directly at odds with the First Circuit's decisions in *Family Winemakers of California v. Jenkins*, 592 F.3d 1, 13 (1st Cir. 2010), and *Walgreen Co. v. Rullan*, 405 F.3d 50, 58 (1st Cir. 2005), and the Sixth Circuit's decision in *Cherry Hill Vineyards, LLC v. Lilly*, 553 F.3d 423, 433 (6th Cir. 2008), which found discriminatory effects where (as in *Wal-Mart*) the laws were facially neutral and the favored group was not exclusively composed of in-state entities.

Washington downplays the other cases rejecting discrimination by proxy as turning on inadequate evidence of discriminatory effects. BIO 29-33. But the question of what evidence is legally sufficient—and in

particular, when discrimination by proxy violates the Commerce Clause—is precisely the legal question presented by this case. As the Petition explains (at 16-18), these cases answer that fundamental question differently than the numerous cases described above.

II. The Washington Surtax Is Unconstitutional Discrimination By Proxy.

A. Washington's defense of the surtax turns on irrelevant features and precedents.

Under this Court's precedents, a law unconstitutionally discriminates against interstate commerce when it disproportionately burdens out-of-state entities based on a proxy for extensive participation in interstate commerce. Pet. § II. Washington primarily defends the surtax on grounds that have nothing to do with whether it is discriminatory. Specifically, Washington says the surtax is constitutional because it bears a substantial nexus to the state, the tax *base* is fairly apportioned, and the surtax does not apply to extra-jurisdictional income. BIO 14-16, 20-24.

Washington's emphasis on apportionment is particularly misplaced. As the Petition explains (at 26), it is irrelevant that the surtax is measured only on in-state income (which means the "tax base" is fairly apportioned, BIO 15); rather, the discrimination inheres in the tax *rate*, which is greatly increased on the basis of profits that any affiliate in the taxpayer's "group" earns around the world (which means the tax rate is *not* fairly apportioned to in-state profits).

Washington ignores this critical point about the discriminatory tax *rate*. All of its cases (at 15-16) involve apportioned tax *bases*. But the discriminatory tax rate is what makes the law unconstitutional and sets it apart from every other graduated corporate income or business gross receipts tax—save for the equally suspect digital services tax Maryland and other states have recently proposed. *See* COST Br. 13-22; Chamber of Commerce Br. 4; IPT Br. 18. Given the uniquely pernicious rate trigger here, it is simply not true that "Petitioners' theory would call all [graduated taxes] into question." BIO 1-2; *see* COST Br. 10.

It is similarly beside the point whether the surtax is extraterritorial. BIO 20-24. The question in this case is one of discrimination. Moreover, in the cases cited by Washington, the Court resolved claims under the Due Process and Equal Protection Clauses, not the dormant Commerce Clause; reversal here therefore would not "overturn" a single precedent, let alone "decades of [it]," BIO 24.[2] Even then, the question was not whether there was discrimination (the question presented in this case), but whether any discrimination was "arbitrary" or "[ir]rational"[3]—a standard

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[2] Of the six lower-court decisions cited by Washington (at 22-23), only one involved the Commerce Clause, and there the court concluded that the "factual predicate" of the claim—that the law discriminates against foreign income—was absent because the law "does not tax foreign income." *Walters v. State ex rel. Oklahoma Tax Comm'n*, 935 P.2d 398, 402 (Okla. Civ. App. 1996).

[3] *Great Atl. & Pac. Tea Co. v. Grosjean*, 301 U.S. 412, 419, 422 (1937); *Maxwell v. Bugbee*, 250 U.S. 525, 542 (1919); *Fox v. Standard Oil Co.*, 294 U.S. 87, 101 (1935).

much lower than the Commerce Clause's standard of "*per se* invalid[ity]," *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 392 (1994). That presumably is why neither Washington nor the Washington Supreme Court even cited those cases below.

B. The decision below is irreconcilable with this Court's precedents.

1. When it comes to the surtax's discriminatory *effect*, Washington (like the decision below) repeatedly asserts that the surtax is *facially* neutral. BIO 17-19. But facial neutrality does not excuse discriminatory effects. *See* Pet. 11, 19-20, 29 (citing cases). A contrary rule would immunize a broad swath of discriminatory laws, thereby "depriv[ing] th[e] [discriminatory-effects] rule of all force." Chamber of Commerce Br. 3; *see* Pet. 28-30.

2. Washington fails to reconcile the decision below with this Court's numerous authorities concerning discriminatory effects. *See* Pet. 19-22.

Like the court below, Washington is wrong to rely (at 12-13, 19-20) on *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981), and *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978). *See* Pet. 22-26 & n.8. In *Commonwealth Edison*, for example, there was no discrimination because all the taxpayers were based in state; the impact on out-of-staters was merely second order.

At most, those cases stand for the proposition that some incidental disparate impact on out-of-state companies does not necessarily establish unconstitutional

discriminatory effects. But that does not mean that such disparate impact is "of no moment." Pet. App. 14a. And nothing about the discriminatory effect here was incidental: It is the direct effect of the Legislature's decision to regulate based on a proxy for participating in interstate commerce. In short, *Exxon* is not the relevant authority when a law "discriminates among affected business entities according to the extent of their contacts" with the interstate economy. Pet. 25 (quoting *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 42 (1980)) (emphasis omitted). Here, the Washington Legislature selected a trigger for the tax that does just that.[4]

That makes this case like *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), *see* Pet. 21, notwithstanding Washington's attempt to distinguish *Fulton* on the ground that "the amount of a company's revenue subject to Washington's tax does not increase based on the *amount* of business conducted outside the state." BIO 18 (emphasis altered). Although the measure of the tax *base* does not increase in proportion to out-of-state activity, a company's out-of-state activity triggers a higher tax *rate*, nearly doubling the tax rate levied on that tax base. In short, targeted "megabanks" (Pet. 5) owe more tax precisely because they "participate[] in interstate commerce," *Fulton*, 516

[4] Washington is also wrong that *Exxon* supports the Washington Supreme Court's conclusion "that added costs alone cannot possibly suffice to show discriminatory effects," BIO 20—an admission that the lower court indeed held increased costs are necessary, not sufficient, for a constitutional violation. Washington ignores the many ways in which that position is contrary to *Exxon* (and other precedents) and is the subject of yet another circuit split. Pet. 24-25; *supra* 5.

U.S. at 333. This Court struck on similar grounds the taxes in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 392-95 (1984), and *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), discussed at Pet. 21-22—cases Washington also ignores.

Finally, Washington seeks to distinguish the critical cases *Hunt v. Washington State Apple Advertising Commission,* 432 U.S. 333 (1977), and *Best & Co. v. Maxwell*, 311 U.S. 454 (1940). It argues they are inapposite because in those cases "the challengers demonstrated an actual discriminatory effect." BIO 18. But Petitioners likewise have shown that the surtax, although ostensibly neutral on its face, heavily burdens out-of-state competitors and does so based on participation in extensive interstate commerce. *Supra* 1; Pet. 20-21.

Washington responds by offering up new evidence before this Court—an attorney affidavit, drafted just days ago, that purports to summarize confidential taxpayer records. BIO App. 1a. This wildly inappropriate submission bespeaks desperation in the face of the undisputed record showing the statute's grossly discriminatory effect. It relies on confidential, extra-record taxpayer information that has not been authenticated, and which Petitioners have not seen. Washington did not take even the minimal step of complying with Rule 32.3 governing the lodging of non-record material. Moreover, these records hurt rather than help Washington. Even on Washington's account, fully 92% of surtax-payers are based out of state. Tellingly, Washington omits what percentage of *revenue* the 8% of in-state businesses pay, but what the actual record in the case shows is that in-state

taxpayers paid only 0.26% of that revenue. Pet. 7. And nothing in this extra-record evidence undermines the critical fact that, by operation of the Washington statute, 100% of institutions pay the surtax *only* because they are affiliated with out-of-state networks.

III. This Case Is An Ideal Vehicle.

Washington is wrong that this case is an imperfect vehicle to address the question presented.

Washington criticizes Petitioners for initiating this suit before the law went into effect. BIO 36. But it would be senseless to insist that a plaintiff wait years to bring a discriminatory-effects claim in a case like this, where the discrimination is baked into, and plain from, the law's trigger.

Moreover, Washington does not deny that when the lower courts decided the case, the law was in force; there was a record of its discriminatory effects; and that record—on which the courts based their decisions—was uncontested. The issue is fully ripe for review.

Nor, contrary to Washington's suggestion (at 36-37) is the evidence of the Legislature's discriminatory purpose any less reason to hear this case. That evidence confirms that the surtax "falls by design in a predictably disproportionate way on out-of-staters" and on interstate activity, *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 579 (1997). In other cases, it might not be so apparent what the Legislature was up to. Here, there can be no doubt, and it is all the more reason to grant

review to ensure that a legislature cannot avoid constitutional scrutiny through artful drafting.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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May 20, 2022