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Re: Cause No. D-1-GN-13-002414; *Texas Small Tobacco Coalition vs. Susan Combs, Comptroller of Public Accounts of the State of Texas, et al. et al in the 98th Judicial District Court, Travis County, Texas*

Dear Counsel:

This letter is to announce my intended rulings and to explain some of my reasoning, but it is not to be incorporated in my orders and does not limit the possible bases of support for those orders.

I will deny the plea to the jurisdiction. The recent opinion of the Third Court of Appeals is the only one addressing whether the amended version of the tax statute violates the Open Courts provision of the Texas Constitution, and it holds that it does violate the provision. The Third Court considered the prior Texas Supreme Court cases relied upon by the State here and found that they did not mandate a contrary conclusion.[1] This court, therefore, has jurisdiction, at

[1] The Texas Supreme Court has not ruled on the amended version of the provision at issue. The *dicta* in the *Nestle I* footnotes does not, as the State argues, indicate the Supreme Court's view of the amended provision. The first footnote merely states that the legislature amended the provision "to preclude" an Open Court's challenge, and the immediately following footnote makes clear that the litigants did not raise the question of whether the legislature actually succeeded in its effort. The other Supreme Court case relied upon by the State, *Allcat*, addresses the Supreme Court's original jurisdiction over a constitutional challenge to the franchise tax. The constitutionality of the amended provision at issue was

the very least, to consider the constitutional challenge pursuant to the statutory mechanism of the Declaratory Judgment Act.

On the merits, there is no precedent in the Texas courts to guide me. Only two other states have a similar tax, and the Texas Supreme Court has identified only one of those states as having a similar equal-and-uniform clause. That state's tax has not been challenged on the basis of its equal-and-uniform tax clause. A similar tax has been upheld only in the state with the *dissimilar* equal-and-uniform clause.[2]

All the other states have enacted escrow statutes, which, despite any *dicta* to the contrary, differ from a tax. In *Star Scientific*, the court stated Virginia's escrow statute required non-settling manufacturers to "essentially provide a surety bond against future liability for tobacco-smoking related healthcare costs." The State cites *dicta* noting that a state "surely could" enact a tax on all manufacturers and then give a tax credit to those who signed the settlement. But that case involved an equal protection challenge, not a challenge based on an equal-and-uniform clause. In Texas, for purposes of the equal-and-uniform clause, a tax on all businesses with a later-enacted exemption for certain businesses is no different from a tax that exempts those businesses in the tax itself. (As it must be to prevent form over substance.) Any argument, therefore, justifying a tax classification based on a supposition about the permissibility of a tax credit is circular.

The question of first impression here is whether, when taxing identical products sold by competitors, establishing one tax classification for those who previously settled a lawsuit with the state and another classification for their competitors violates the Texas Constitution's equal-and-uniform tax clause. The Third Court of Appeals has instructed, as have all other Texas courts in similar language, "we must look to the nature of the business conducted to determine the appropriateness of the classifications." *American Home Insurance*. Although a slight difference justifies a separate classification, it must be a difference "in the subject matter taxed." *Id.*[3] All other Texas precedents also hold that a tax classification must be reasonable with respect

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not raised in that case either. The Court's discussion of the provision was limited to its significance in determining the legislature's intent regarding two related statutes.

[2] With all due respect to the court in that state, even on its own terms, I do not find the opinion persuasive.

[3] The Third Court's opinion in *American Home Assurance* upheld separate classifications for private workers compensation insurance providers and the state's insurer of last resort noting that the latter has the responsibility to insure high-risk employers – a difference in the nature of the businesses. The opinion does state, under those facts, the legislature might properly have considered a difference in profits. The difference in profits arose from the difference in the nature of the businesses. This is not

to the "nature of the businesses classified."[4] The classification here is not reasonable with respect to the nature of the businesses classified because it does not relate at all to the nature of the businesses. I will grant the Plaintiff's motion for summary judgment and the relief sought and deny the State's motion.

Please prepare orders consistent with the intended rulings and without any limitation on the bases for those rulings, so that the higher courts may consider all arguments.

Sincerely,

Stephen Yelenosky
Judge, 345th District Court
Travis County, Texas

SY/ar
Original: Hon. Amalia Rodriguez-Mendoza, District Clerk
Cc: Bill Cobb, Counsel for Amicus Curiae, ***Via fax:(512) 691-4446***

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precedent for the proposition that the legislature may "level the playing field" by taxing more profitable businesses within the same classification.

[4] Amicus Curiae contend Plaintiffs conceded that equal-and-uniform requires only a "rational basis," citing three portions of Plaintiffs' motion, two of which clearly – by heading and text - discuss only Plaintiffs' *equal protection* claim. The third portion does discuss equal-and-uniform, but it does not say it requires only a rational basis. In any event, Supreme Court precedent establishes that the equal-and-uniform clause is more demanding than the equal protection clause.