No. 08-721

IN THE

Supreme Court of the United States

FIRST AMERICAN TITLE INSURANCE COMPANY AND OLD REPUBLIC NATIONAL TITLE INSURANCE COMPANY,
Petitioners,

v.

SUSAN COMBS, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, AND GREGG ABBOTT, ATTORNEY GENERAL OF TEXAS,
Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Texas

REPLY FOR PETITIONERS

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CORPORATE DISCLOSURE STATEMENT

Petitioners First American Title Insurance Company and Old Republic National Title Insurance Company state that the corporate disclosure statement included in the petition remains accurate.

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REPLY FOR PETITIONERS

For decades, States have computed retaliatory tax by comparing premium taxes in the insurer's home State with premium taxes in the retaliating State. Now, Texas—*alone out of all 50 States*—*deems title insurers to* "pay" only 15% of the premium tax they remit; the rest is deemed "paid" by their agents and then excluded from the retaliatory tax calculation. It is undisputed that *no* other State deems part of the insurer's tax "paid" by another entity in that fashion. To the contrary, respondents concede that Texas's approach is "unique." Br. in Opp. 1. Nor do respondents identify any State that collects premium taxes from agents directly. Cf. Pet. 21 & n.6. The incontrovertible result is that Texas now compares 100% of premium taxes elsewhere with 15% of premium taxes in Texas.

As four justices of the Texas Supreme Court explained, that result completely divorces the retaliatory tax from its permissible purpose of equalizing and moderating taxation of the national insurance industry. To avoid retaliation, other States must now either reduce their premium taxes to less than *one-sixth* of Texas's level or else adopt Texas's novel approach of shifting the taxes to other entities and then excluding them from the retaliatory-tax calculation. Texas has no legitimate interest in pursuing either goal, and could not rationally expect to achieve either in any event. And despite respondents' efforts to downplay the case's importance, the outpouring of industry concern—nearly 90% of the Nation's title insurance industry has now weighed in—confirms that the case warrants this Court's review.

I. RESPONDENTS DISTORT THE RELEVANT ISSUES

A. Attempting to avoid review, respondents obfuscate the issues. They begin by defending the Texas Supreme Court's state-law holding that title insurers in

Texas are mere "pass-through entities for title agents' premium taxes." Br. in Opp. 3. Respondents claim that petitioners have no cause to complain because "85% of the premium taxes do not come 'out of their pocket,' so to speak." *Id.* at 2. But, while Texas is certainly entitled to adopt Rube Goldberg collection mechanisms in which taxes collected from one taxpayer are deemed paid out of someone else's "pocket" for state-law purposes, Texas cannot then retaliate against insurers from 49 other States merely because those States have not imitated Texas's idiosyncratic approach. Texas's tax is unconstitutional, not because it involves a collection mechanism, but because Texas—unlike any other State—uses that mechanism to exclude 85% of the premium tax it collects when making retaliatory-tax comparisons.

The same constitutional defect would exist *even if* Texas actually collected those taxes from agents directly. Other States impose premium taxes on *insurance companies*, not agents. See Pet. 21 & n.6. That is not surprising, because premium taxes are *insurance* taxes and insurance companies—not agents—perform the traditional insurance functions of underwriting policies and paying claims. See *id.* at 4-5. Texas, by contrast, now imposes most of those taxes on *agents*. Retaliatory taxes simply do not work when one State artificially "lowers" its tax burdens by shifting them to entities that it excludes from the comparison. Thus, although it is certainly telling that Texas did not even bother to revise its collection procedures when it decided to reconceptualize who "pays" 85% of its premium tax, the State's retaliatory tax is unconstitutional even accepting its "collection mechanism" theory as *bona fide*.[1]

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[1] For that reason, the State's new rule relieving insurers of liability when an agent fails to pass on the insurer's share of the premium (34 Tex. Admin. Code § 3.831(4)(C))—promulgated for the *precise*

B. Respondents also repeatedly urge that retaliatory taxes should compare "dollar amount[s]" rather than "tax rate[s]." See Br. in Opp. 7-9, 15, 20. But the defects in Texas's approach are readily apparent under either analysis. In respondents' view, Minnesota and California insurers should pay retaliatory tax in Texas because, with an 85/15 split on a $1,000 premium, the *insurance company's* tax burden would be $20.00 in Minnesota and $3.53 in California, but only $2.03 in Texas. See *id.* at 8-9. Of course, the reason Texas's tax burden looks so low is that $2.03 is only the *insurance company's* so-called share.

Minnesota would impose a 2% premium tax on the $1,000 premium and deem the *entire* $20.00 paid by the insurance company, not the agent. See Br. in Opp. 8-9; Minn. Stat. § 297I.05(1); *Stewart Title Guar. Co.* v. *Comm'r of Revenue*, 757 N.W.2d 874 (Minn. 2008). Texas would impose a 1.35% tax on that same premium, but would deem $2.03 paid by the insurer and the other $11.47 (*i.e.*, $1,000 × 85% × 1.35%) paid by the agent. See Br. in Opp. 8-9. Texas would then compute retaliatory tax by comparing the entire $20.00 tax in Minnesota with the insurer's $2.03 share in Texas. See *ibid.* By ignoring the $11.47 tax on the agent, Texas makes Minnesota's premium tax look *ten times* larger than its own. Minnesota would have to reduce its premium taxes *tenfold* to avoid retaliation, even though there is only a modest difference between the total amount of tax each State collects on the $1,000 premium. That makes no sense.

Retaliating against California insurers makes no sense either. California would impose a 2.35% tax on the in-

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purpose of legitimizing the Comptroller's earlier reinterpretation of the State's premium tax, see Br. in Opp. 6—is beside the point. That rule may add some fig leaf of substance to the State's theory that title insurers are mere pass-through entities, but it does not alter the State's exceptionality in imposing premium taxes on agents.

surer, but on a different basis: The tax is a percentage of the insurer's share of the premium rather than the entire premium. See Br. in Opp. 8; Cal. Rev. & Tax. Code §§ 12202, 12231; *In re Ticor Title Ins. Co.*, Nos. IT HQ 34-001820-010 *et al.*, 1994 Cal. Tax LEXIS 15 (Cal. Bd. of Equalization Jan. 5, 1994).[2] The tax on the insurer would thus be $3.53. See Br. in Opp. 8-9. Like Minnesota and other States, and unlike Texas, California does not impose any premium tax (or other insurance-related tax) on agents. See *id.* at 8. California's tax of $3.53 is far less than the total of $13.50 that Texas imposes. But by shifting $11.47 of its tax to the agent, Texas again retaliates for no rational reason.[3]

II. THE PETITION PRESENTS AN ISSUE OF SUBSTANTIAL IMPORTANCE TO THE INSURANCE INDUSTRY

A. The decision below threatens grave harm to the Nation's insurance industry, for at least three reasons. First, out-of-state title insurers across the country will

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[2] As explained in the petition (Pet. 21 n.6), some States (like Minnesota) calculate the insurer's tax as a percentage of the entire "gross" premium, see *Stewart Title Guar. Co.* v. *Comm'r of Revenue*, 757 N.W.2d 874 (Minn. 2008); *Stewart Title Guar. Co.* v. *State Tax Assessor*, 963 A.2d 169 (Me. 2009), while others (like California) calculate it as a percentage of the insurer's "net" share, see pp. 3-4, *supra*. That difference is irrelevant here: Retaliatory taxes work properly, however premium taxes are computed, so long as the entire premium tax is included in the comparison. See Pet. 21 n.6.

[3] Generally applicable business taxes and the like are normally not included in the retaliatory-tax calculation because they are not insurance-related. See *Mut. Life Ins. Co. of N.Y.* v. *Washburn*, 561 N.E.2d 29, 36-37 (Ill. 1990); *Franklin Life Ins. Co.* v. *State Bd. of Equalization*, 404 P.2d 477, 484 (Cal. 1965); *Pac. Mut. Life Ins. Co.* v. *Gerber*, 174 N.E.2d 862, 864-866 (Ill. 1961). Thus, the fact that Texas exempts agents from franchise taxes (Br. in Opp. 4 n.3) is irrelevant. In any event, the State can hardly justify its new regime based on differences in taxes on agents when its retaliatory tax does not even attempt to measure those differences.

pay millions of dollars to Texas, year after year for the indefinite future, merely because they are foreign. Second, by dramatically lowering the bar for what counts as "rational," the decision will encourage other States to adopt similar ploys, a concern for both title insurers and the broader industry alike. Finally, the decision raises the prospect of counter-retaliation by other States. See Pet. 22-25. The *amicus* brief filed by seven other title insurers—representing more than $740 million in annual premiums in Texas *alone*—underscores this case's importance: That brief's signatories express alarm at the prospect of "increased retaliatory tax liability on * * * premiums collected in Texas" and fear "retaliation from sister states." Br. of Alamo Title Ins., *et al.*, at 1.

Respondents offer no real answer to most of the petition's claims of importance. They contend in a footnote that the level of *amicus* participation proves this case is *not* important, because only one industry brief was filed. Br. in Opp. 1 n.1. What respondents neglect to mention is that the seven signatories to that brief, along with petitioners and their affiliates, represent *more than 77% of the entire national title insurance industry* measured by premiums earned. See Am. Land Title Ass'n, *2007 Title Insurance Industry Statistical Analysis: Premiums Earned*, http://www.alta.org/industry/07ALL/07_TitleIndustryStatisticalAnalysis_Fam&Co.xls. A further 11% is represented by Stewart Title Guaranty Company, see *ibid.*, a Texas-based insurer that *benefits* from the State's new approach, and which filed an *amicus* brief supporting that approach below. See Post-Submission Letter Br. of Stewart Title Guar. Co. in *First Am. Title Ins. Co.* v. *Combs*, No. 05-0541 (Tex. filed Apr. 16, 2007). That nearly 90% of the Nation's $14-billion-a-year title insurance industry has participated in this case speaks volumes about its importance. Moreover, a trade association representing 93% of the Nation's *life* insurers filed

an *amicus* brief urging rehearing below, warning of "significant harm to the nationwide retaliatory tax system" from the Texas Supreme Court's decision. Br. of Am. Council of Life Insurers at 1-2, 5, in No. 05-0541 (Tex. filed July 28, 2008) ("ACLI Amicus Br."). The case is thus important to the broader industry as well.

Respondents dispute the likelihood of counter-retaliation (which, to reiterate, is only *one* of the reasons this case is important). While conceding that the Minnesota revenue notice is "evidence of possible counter-retaliation," respondents stress the absence of other examples. Br. in Opp. 21-22. That absence, however, is not surprising: The Comptroller's approach was not definitively upheld as a matter of state law until the Texas Supreme Court recently ruled, and its constitutionality still has not been conclusively determined.

Respondents claim the Minnesota notice is "not even on point" because it does not describe Texas's tax regime the same way Texas describes it. See Br. in Opp. 22. Of course, the Minnesota notice is written the way it is because its author (like much of the industry) views Texas's description as a sham. The Minnesota notice is commonly understood to represent counter-retaliation against Texas, see, *e.g.*, ACLI Amicus Br. 9-11, and viewed in context, that is its plain intent. Although respondents suggest that Minnesota might change its mind now that the Texas Supreme Court has "authoritative[ly] interpret[ed]" Texas law, they offer no credible basis for that prediction. Br. in Opp. 22. The irrationality of the Comptroller's approach has not gone away just because a bare majority of the Texas Supreme Court endorsed it.[4]

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[4] Although not precedential, Minnesota revenue notices "may be relied on by taxpayers until revoked or modified." Minn. Stat. § 270C.07(2). In any event, the notice is the best evidence of how Minnesota will interpret its tax regime in light of Texas's position.

Finally, respondents point to a recently enacted provision of Texas law that allows the Comptroller to abate retaliatory taxes if, after "negotiat[ing]" with another State, she determines such taxes are "not the preferred way to avoid excessive taxation." Br. in Opp. 22-23 (citing Tex. Ins. Code § 281.008). While not suggesting that this newly minted negotiation authority could render an otherwise invalid tax constitutional, respondents contend that it diminishes the case's importance. See *ibid.* But the Comptroller's utterly discretionary authority—to reduce taxes on foreigners if the Comptroller "prefer[s]" not to impose them—is so unlikely to be exercised in this instance that it has no conceivable bearing on this case's importance. The Comptroller has been defending the State's approach in the courts for years; there is no realistic possibility that other States will persuade her to abandon the approach of her own accord. Besides, insurers who have already been paying Texas's discriminatory tax for almost a decade will derive no comfort from the Comptroller's as-yet-unexercised authority.

B. Respondents devote much of their brief to disputing the level of conflict among the courts, emphasizing that the other cases cited in the petition involved "different statute[s]" and "did not consider the effect of premium taxes imposed on someone other than the insurer." Br. in Opp. 13-19. That is true enough: The petition did not claim otherwise. See Pet. 19. But that does not make the cases irrelevant.

Cases such as *United Services Automobile Ass'n* v. *Curiale*, 668 N.E.2d 384 (N.Y. 1996), and *American Fire & Casualty Co.* v. *New Jersey Division of Taxation*, 912 A.2d 126 (N.J. 2006), involved *parallel* issues because each involved a State's effort to impose retaliatory tax in a way that divorced the tax from its legitimate equalizing and moderating purpose. New York did so by characterizing part of its tax as a mass-transit surcharge that it

excluded from the retaliatory-tax comparison. See Pet. 17-18. New Jersey did so by interpreting its retaliatory tax to negate any benefits under its tax-cap statute, resulting in substantial retaliatory taxes on foreign insurers even where their home States had lower premium taxes. See *id.* at 16-17. Texas has now done so by shifting most of its premium tax to agents. The statutory artifice employed in each case is different, but the constitutional defects are the same.

Petitioners have never claimed a direct conflict involving identical state taxes. But this case warrants review nonetheless. It is enormously important to the industry; disputes of this general nature are recurring; and the decision below flies in the face of this Court's precedents. See Sup. Ct. R. 10(c). Refusing to review cases like this simply because there is no direct conflict involving identical state taxes would effectively insulate such decisions from scrutiny altogether. Texas's approach is unconstitutional *precisely because* it is "unique" (Br. in Opp. 1): Texas now retaliates against essentially *all* foreign title insurers, not because of any substantive difference in tax levels, but because Texas has its own unique way of allocating premium tax. And because there are an infinite number of ways in which States can manipulate their own unique tax regimes to produce similarly broken retaliatory-tax results, direct conflicts are unlikely to arise. That does not diminish the potentially devastating consequences for the industry or the importance of ensuring that States pay more than lip service to this Court's precedents.

III. RESPONDENTS FAIL TO RECONCILE THE DECISION BELOW WITH THIS COURT'S PRECEDENTS

Respondents' arguments on the merits are insubstantial. Citing *Western & Southern Life Insurance Co.* v. *State Board of Equalization*, 451 U.S. 648 (1981), re-

spondents argue that Texas's retaliatory tax cannot be unconstitutional because it accounts for only a small portion of the State's budget—at most, a supposedly "modest" $12 to $17 million per year. Br. in Opp. 24. But size cannot legitimize an otherwise unconstitutional discriminatory tax. See *Fulton Corp.* v. *Faulkner*, 516 U.S. 325, 333 n.3 (1996); *Westinghouse Elec. Corp.* v. *Tully*, 466 U.S. 388, 405-407 (1984). Respondents' implausible suggestion that the amounts at stake are so small that state officials could not possibly have cared enough to have acted for an improper purpose is belied by their own conduct. The State and the industry have vigorously litigated this issue for years, proving that those tens of millions of dollars *do* matter. Besides, petitioners have no burden to show that the tax reflects an illegitimate purpose (whether to raise revenue or to favor one or more domestic title insurers at the expense of foreign competitors)—only that it could not rationally be expected to promote a legitimate one. See *Western & Southern*, 451 U.S. at 668.

Western & Southern did mention the "relatively modest" amounts raised by California's tax, *among several other factors*, in upholding it. See 451 U.S. at 668-671. But that case obviously does not stand for the proposition that States can enact whatever discriminatory taxes they like—however unlikely the taxes may be to promote uniformity and moderation of taxation of the national insurance industry—so long as the State's "take" isn't too large. This Court upheld California's tax because it was "virtually identical to [taxes imposed] by many other States" and thus could rationally be expected to promote uniformity and moderation. *Id.* at 669-670. Texas's aberrant tax has no such effect.

Respondents caricature the petition as asserting that Texas's retaliatory tax is unconstitutional merely because its premium tax is "too low." Br. in Opp. 25. The prob-

lem is not that Texas's premium tax is "too low." The problem is that the State has artificially made the tax *appear* low by shifting 85% of it to other entities that the State then excludes from the retaliatory-tax comparison—something no other State does.

Finally, respondents dismiss this Court's precedents on the ground that they involved attempts to impose higher taxes on foreign insurers "simply because they [we]re foreign." Br. in Opp. 26-27. But that is what Texas does too. Because Texas now artificially excludes 85% of its premium tax in computing retaliatory tax, Texas's burdens will inevitably appear much lower than any other State's. Respondents do not identify a *single State* whose insurers would not pay retaliatory tax merely for doing business in Texas. Texas may have accomplished that result by more subtle means than those attempted in the past, but the result is no less pernicious.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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