ENOCH KEVER

Craig T. Enoch
Direct (512) 615-1202
cenoch@enochkever.com

July 17, 2014

Jeffrey D. Kyle, Clerk
Third Court of Appeals
Price Daniel Sr. Building
209 West 14th Street, Room 101
Austin, Texas 78701

Re: Cause No. 03-13-00753-CV; *Susan Combs, in Her Official Capacity as Texas Comptroller, and Greg Abbott, in His Official Capacity as Texas Attorney General v. Texas Small Tobacco Coalition and Global Tobacco, Inc.*, in the Third Court of Appeals.

Dear Mr. Kyle:

With the Court's permission, Appellees Texas Small Tobacco Coalition and Global Tobacco, Inc. (collectively, "Small Tobacco") wish to briefly respond to two questions raised during oral argument. Please distribute a copy of this letter to the justices on the panel for this case.

First, Small Tobacco's counsel mistakenly thought Justice Field's question asking whether there is a distinction between this tax and one the Court recently upheld referred to *Combs v. Texas Entertainment Ass'n, Inc.*, 287 S.W.3d 852 (Tex. App.—Austin 2009) (*TEA I*), which concerned First Amendment issues. After argument, counsel realized Justice Field's question referred to *Texas Entertainment Ass'n v. Combs*, No. 03-12-00527-CV, 2014 WL 1884267 (Tex. App.—Austin May 9, 2014, no. pet. h.) (*TEA II*). Justice Field asked if the Court's reasoning regarding the Equal and Uniform Clause in *TEA II* was contrary to Small Tobacco's position in this case. It is not. In *TEA II*, the tax was assessed against clubs providing nude entertainment to audiences of two or more. TEA's complaint was that the tax did not apply to other nude entertainment businesses, such as nude modeling studios and adult arcades. *Id.* at *6-7.

The distinction between the tax statute in that case and the tax statute challenged here is apparent. The tax statute in *TEA II* identified clubs providing nude entertainment to two or more patrons and ***taxed all of them***. Thus, for well-settled jurisprudential reasons, this Court correctly rejected TEA's claim that distinguishing between adult entertainment for two or more patrons and adult entertainment for only one viewer was an impermissible classification. Because the natures and operations of businesses catering to social viewing of nudity are distinct from those catering to single viewing, the Equal and Uniform Clause was not violated. Conversely, the tax statute here identifies identical cigarette products manufactured by identical types of tobacco manufactures and ***taxes only some of them***. The legislature expressly excluded from the tax some businesses whose products, natures, and operations are the same simply because those select businesses had private agreements with the state.

Indeed, in *TEA II*, the Court concluded that the legislature's classification was rational by observing that the difference in the ***natures*** of the businesses warranted a distinction because strip clubs serving alcohol potentially cause more adverse secondary effects than nude entertainment geared towards an individual. But here, there is no distinction between the product, nature, and operations of Small Tobacco and Big Tobacco's businesses. As such, there is no basis for concluding that Small Tobacco's products and businesses could have more adverse secondary effects than Big Tobacco's. To the extent cigarettes impose health risks—which is true of many products, including alcohol, tanning booths, and junk food—the health risks caused by the cigarettes of Big Tobacco and Small Tobacco are identical. Surely even the State would concede that if Hershey committed antitrust and DTPA violations leading to settlement agreements while Nestle did not, it would be constitutionally impermissible to tax Nestle but not Hershey simply because junk food consumption increases healthcare costs.

TEA II does not stand for the proposition that ***any*** tax motivated by a "good" public policy is constitutional. A tax violates the Equal and Uniform if it treats identical businesses selling identical products differently. In *TEA II*, the Court would have likely held the tax was unconstitutional if it was imposed against only one group of strip clubs but not another, solely on the basis of one group's lawsuit settlements. All competitors within a single class of business are sued in differing ways and with differing frequency. If it is legitimate to use settlement agreements as a basis for a classification, it is difficult to find any meaning remaining in the Equal and Uniform Clause.

Second, the Court asked whether legislation taxing all tobacco products, yet offering Big Tobacco a credit or deduction for amounts paid under the settlement agreements, would violate the Equal and Uniform Clause. The answer is yes. In analyzing whether a tax credit is constitutional, a court should determine whether all competitors within a tax classification are treated equally under a statute. The Equal and Uniform Clause, and the analysis used in evaluating the constitutionality of tax mechanisms, applies not only to the assessment of direct taxes but to tax credits, exemptions, and deductions. *See In re Nestle USA, Inc.* (*Nestle II*), 387 S.W.3d 610, 616, 624 (Tex. 2012) (evaluating the franchise tax structure, including various deductions and exemptions, under the Equal and Uniform Clause); *Sharp v. Caterpillar, Inc.*, 932 S.W.2d 230, 240 (Tex. App.—Austin 1996, writ denied) (evaluating whether a company franchise tax deduction was valid under the Equal and Uniform Clause); *Am. Home Assurance v. Tex. Dep't of Ins.*, 907 S.W.2d 90, 97 (Tex. Civ. App.—Austin 1995, writ denied) (analyzing constitutionality of a tax credit under the Equal and Uniform Clause); *see also Pullman Palace–Car Co. v. State*, 64 Tex. 274 (1885) (evaluating whether an exemption exclusively for railway owners under an occupation tax was a violation of the Equal and Uniform Clause). Thus, if the State granted Big Tobacco a tax credit for amounts paid under the settlement agreements, the credit would violate the Equal and Uniform Clause.

For the reasons briefed and argued before this Court, Small Tobacco respectfully requests that the trial court's judgment be affirmed.

Thank you for your consideration.

Sincerely,

/s/*Craig T. Enoch*
Craig T. Enoch

cc: Arthur C. D'Andrea
Erika M. Kane

CERTIFICATE OF COMPLIANCE

Relying on the word count function in the word processing software used to produce this document, I certify that this Response (when excluding the sections excluded in Texas Rule of Appellate Procedure 9.4(i)(1)) contains 953 words.

/s/ Craig Enoch
Craig T. Enoch