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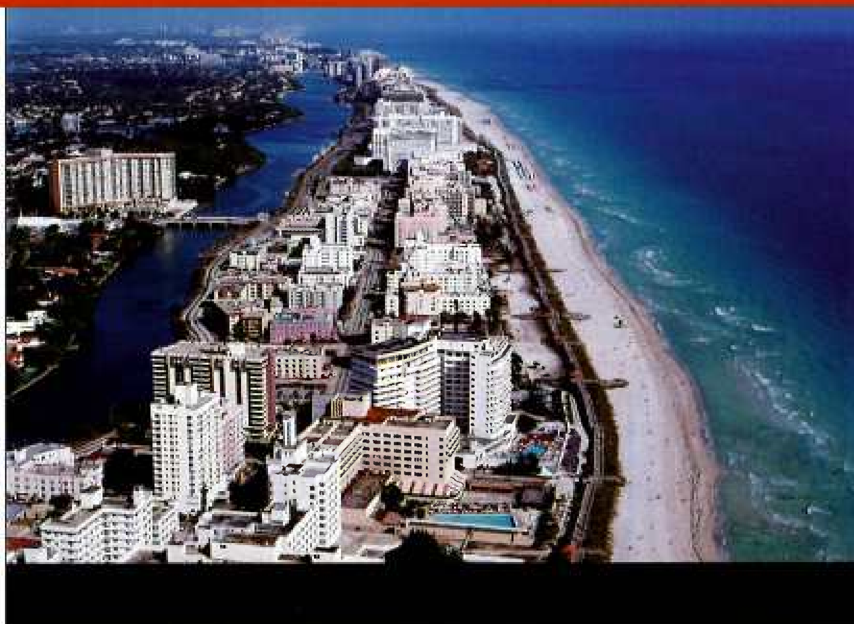

At Long Last, DIRECTV Prevails in Commerce Clause Discrimination Challenge

Are cable and satellite television providers "similarly situated" for Commerce Clause purposes? That question has been at the forefront of DIRECTV's state tax challenges in courts across the nation for over a decade. DIRECTV has repeatedly claimed that cable and satellite companies are similarly situated based on their direct competition in the same television programming market. Because states often tax satellite companies at higher rates, and cable companies tend to provide more localized services, DIRECTV claims that this discriminatory tax treatment against non-local satellite companies violates the Commerce Clause of the U.S. Constitution.

Until recently, DIRECTV had repeatedly lost that argument. In at least six appellate decisions across the country, courts uniformly rejected DIRECTV's constitutional arguments and upheld states' disparate treatment of cable and satellite providers. The analysis varied slightly from case to case, but the primary theme running through those opinions has been that cable companies and satellite providers are fundamentally different. For instance, courts have pointed out that the companies provide television programming using different technology and operate under different federal regulatory schemes.

DIRECTV's long losing streak finally came to a halt recently, however, in *DIRECTV, Inc. v. State of Florida, Department of Revenue*, 2015 WL 3622354 (Fla. Ct. App. June 11, 2015). In a 2-1 decision, the Florida Court of Appeal struck down a Florida sales tax statute that imposed a higher rate on satellite service providers than cable providers. The court applied a far simpler approach than other courts in determining the threshold constitutional question of whether the companies were "similarly situated." Acknowledging that the companies differ in their use of technology and method of providing television programming, the court nonetheless held that the companies are similarly situated because they "operate in the same market and are direct competitors within that market." The court's analysis on that issue went no further.

The court then concluded that Florida's imposition of a higher tax rate on satellite providers discriminated against out-of-state interests. The court reasoned that cable companies provide "local" services—due to their use of local infrastructure (such as public rights of way in installing cable)—while satellite companies provide non-local services, due to their transmission of signals from out-of-state facilities to satellites orbiting the earth and back to subscribers' homes. The court held that this discriminatory treatment against out-of-state interests violated the Commerce Clause.

This case not only serves as a reminder that the Commerce Clause remains a viable basis to challenge discriminatory state tax schemes, but it also demonstrates the power of stubborn optimism and persistence in challenging tax laws. Even if one court (or, in this case, more than a half-dozen) rejects a company's tax relief claims, such a loss does not necessarily sound the death knell of that claim everywhere. Here, DIRECTV's tenacity has paid off in Florida (at least for now).

Background. DIRECTV and other satellite companies transmit television programming signals from "uplink facilities" located outside Florida (in Arizona, California, Colorado, and Wyoming) to satellites orbiting the earth. Those signals are then directed to small satellite dishes mounted on or near subscribers' Florida homes.

In contrast, cable companies provide television programming using "local distribution facilities"—i.e., by delivering programming through coaxial or fiber optic cables installed across a ground-based network, usually using public rights-of-way.

Prior to 2001, Florida imposed the same sales tax rate (6%) on cable companies and satellite companies. In 2001, the Florida Legislature passed the "Communications Services Tax Simplification Law" and increased the sales tax rate on satellite companies to 10.8%, while maintaining the cable company tax rate at slightly greater than 6%.

In 2005, DIRECTV filed a lawsuit seeking a declaratory judgment that the Florida statute was unconstitutional based on the Commerce Clause because the statute improperly discriminated against satellite companies as "out-of-state" companies. The trial court disagreed, holding that cable companies and satellite companies were not similarly situated entities and granting summary judgment in favor of the Department of Revenue. DIRECTV appealed.

Exhaustion of administrative remedies not required. The Florida Court of Appeal first addressed the Department's

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argument that DIRECTV's claim must be dismissed because DIRECTV failed to "exhaust administrative remedies." Specifically, the Department asserted that DIRECTV could not file a lawsuit without first filing a refund claim with the Department.

The appellate court acknowledged that DIRECTV had not filed a refund claim with the Department, and that DIRECTV's failure to file such a claim would generally require dismissal. However, the court held that DIRECTV's lawsuit satisfied a "direct-file" exception where the only basis for its lawsuit is that the taxing statute is "facially unconstitutional." A claim is based on facial constitutionality where no set of circumstances exist that could possibly uphold the statute against the constitutional challenge.

Here, DIRECTV asserted that the statute was unconstitutionally discriminatory against all satellite providers, regardless of their circumstances. Based on this claim, the court concluded that DIRECTV's claim was a facial challenge to the statute under the Commerce Clause. DIRECTV's lawsuit was allowed to proceed under the "direct-file" exception.

DIRECTV asserts Florida statute has a discriminatory effect and purpose. The court began its constitutional analysis by noting that a state statute violates the Commerce Clause if it "treats out-of-state commerce differently from in-state commerce." In other words, the court noted, a statute improperly discriminates if it places a "greater economic burden" on industries or companies operating outside the state, giving an "economic advantage" to those operating within the state.

Unconstitutional discrimination can occur if a statute is facially discriminatory, discriminatory in "effect," or discriminatory in its purpose. Because the Florida statute at issue was not expressly discriminatory against out-of-state interests (such as imposing a higher tax rate on all out-of-state companies), DIRECTV argued that the statute was discriminatory in its effect and purpose.

Cable and satellite companies are similarly situated. To establish that a statute is discriminatory in effect, the court must first determine that the companies or industries affected are "similarly situated." The court answered that question in the affirmative on the ground that cable and satellite companies "operate in the same market" and are "direct competitors" in that market. Although the court acknowledged that the companies "differ in the deployment of technology, the need for local infrastructure, and the additional services offered," the court dismissed those distinctions as "mere differences in how a service is provided." The key, the court held, is that satellite and cable companies "compete in the same market and sell virtually identical products at retail."

In contrast, the Tennessee Court of Appeals reached the opposite conclusion several months earlier in rejecting DIRECTV's Commerce Clause claim in another case. In *DIRECTV, Inc. v. Roberts*, 2015 WL 899025 (Feb. 27, 2015), the Tennessee court held that cable companies and satellite companies are not similarly situated primarily because cable companies are subject to extensive federal regulation. For instance, the court noted that cable companies must offer a variety of public service items, such as emergency information and educational stations, while satellite providers are subject to minimal federal oversight. This distinction alone was enough for the *Roberts* court to reject DIRECTV's constitutional claim on the basis that the two types of companies are not similarly situated.

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Interestingly, the Florida Court of Appeal did not address this regulatory distinction. Instead, the court simply held that operating and competing in the same market is enough to be considered "similarly situated."

This illustrates how subjective the "similarly situated" standard can be in practice. Like light through a prism, the comparison between companies or industries can appear very different depending on the court's viewpoint. Courts have reached a variety of outcomes depending on which factors the court considers—even where (as here) the facts involved are identical. Unfortunately, the U.S. Supreme Court has not offered significant guidance in this area, leaving state courts to tackle these issues themselves. On the other hand, this provides opportunities for practitioners to advance creative arguments that companies or industries are "similarly situated."

The Florida tax statute benefits "local" cable companies and burdens non-local satellite companies. After concluding that satellite and cable companies are similarly situated, the court held that a lower tax rate on cable companies benefited in-state business and burdened out-of-state business. The court's reasoning was minimal.

The court first noted that both cable companies and satellite companies operate in "interstate" commerce, as they both maintain their corporate headquarters outside Florida and operate in other states. However, the court held that cable companies "employ Florida workers and use extensive local infrastructure." As the dissent pointed out, the majority did not address the fact that satellite cable companies also hire Florida employees and independent contractors.

Regardless, it is clear that the court relied heavily on cable companies' use of local rights of way to install cable for transmitting television programming signals. Specifically, the court held: "Cable provider's reliance on local rights-of-way transforms its interests into local interests." The transformation of cable companies into "local" interests was the key in the court's conclusion that the Florida statute had a discriminatory effect between in-state and out-of-state interests.

The court further held that courts in three prior rulings against DIRECTV had "misapplied" U.S. Supreme Court case law. In *DIRECTV v. State*, 632 S.E.2d 543 (N.C. App. 2006), *DIRECTV v. Treesh*, 487 F.3d 471 (6th Cir. 2007), and *DIRECTV v. Levin*, 941 N.E.2d 1187 (Ohio 2010), those courts relied on the U.S. Supreme Court's dormant Commerce Clause analysis in *Exxon v. Governor of Maryland*, 437 U.S. 117 (1978) and *Amerada Hess v. Division of Taxation*, 490 U.S. 66 (1988).

However, the Florida Court of Appeal stated that *Exxon* and *Hess* merely held that Commerce Clause discrimination cannot exist where any distinctions between categories of companies "results solely from differences between the nature of their businesses, not from

the location of their activities." The Florida Court of Appeal reasoned that cable companies' use of "local infrastructure" meant that the distinction between companies was not solely based on business activities, but was also based on the "location" of those activities. In other words, the "local" nature of the cable companies' activities was distinct from the nature of the satellite companies' activities, which the court suggested (without express statement or analysis) were not "local."

Optional county tax on satellite companies did not equalize tax rates. One of the Department's main arguments was that the tax rates in most areas were not actually higher for satellite companies because Florida counties were permitted by statute to impose an additional 4% tax on cable companies, resulting in the same overall tax rate as that on satellite companies. Federal law prohibits county tax on satellite companies.

The court rejected this argument, reasoning that there was "no guarantee" that the counties would continue taxing cable companies at that rate and that the Department failed to present evidence about which counties actually imposed the additional 4% tax.

In short, the court concluded that Florida's tax statute had the discriminatory effect of harming out-of-state satellite companies while benefiting "local" cable companies. The optional county tax did not remedy that issue.

No discriminatory purpose. Having concluded that the Florida statute had a discriminatory "effect" on interstate commerce, the court held that the statute violated the Commerce Clause and remanded to the trial court to determine the refund amount owed to DIRECTV. In a somewhat unusual move, however, the court did not stop there. The court went on to address—and reject—DIRECTV's argument that the statute was enacted with an unconstitutionally discriminatory intent or "purpose" as well. It is not clear why the court elected to address this issue, as it was unnecessary in reaching its decision.

The court began by dismissing sworn statements from lobbyists and two former legislators, which indicated that the "intent" of the statute was to protect cable's market share because the satellite industry was expanding. Consistent with other state courts, the court reasoned that the best evidence of legislative intent is the statute itself, not the "testimony of individual legislators" with "subjective intentions."

The court then noted that the statute itself expressly stated that it was designed to "provide a fair, efficient, and uniform method for taxing communications services sold in this state." Nothing in the statute or the Senate and House Journals stated any intent to favor cable companies. As a result, the court rejected DIRECTV's argument that the purpose of the statute was discriminatory.

This holding is understandable but somewhat troubling. After all, it could give legislatures a free pass to enact intentionally discriminatory legislation—so long as the legislature and official legislative materials do not include any expressly discriminatory language. Better yet, the legislature could avoid close court scrutiny altogether by simply stating that the legislature's "intent" in enacting legislation is to create "uniformity"—even where (as here) the legislation is clearly not uniform.

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Dissenting opinion believes prior DIRECTV decisions were correct. One judge dissented for various reasons. She first asserted that the majority opinion failed to "fully consider all the differences" between cable companies and satellite companies, citing the recent decisions in Tennessee (*DIRECTV v. Roberts*) and Massachusetts (*DIRECTV v. Department*, 470 Mass. 647 (2015)) in support of the argument that the two types of companies are not "similarly situated."

More troubling to the dissenting judge, however, was the majority's conclusion that cable companies' use of local infrastructure somehow "transformed" cable companies into "local" companies. She also pointed out that the majority failed to explain why satellite companies were not also "local" companies under the court's analysis. For instance, she noted that DIRECTV also has employees and independent contractors in Florida: "I fail to see how, under these facts, the cable providers have local economic interests, but the satellite providers do not."

The dissent also asserted that DIRECTV had failed to satisfy its "very high burden" of a facial constitutional challenge to the statute. The dissenting judge further argued in the alternative that even if the statute discriminated against satellite companies, the case should be remanded to the trial court for further consideration (presumably to determine the effect of that discrimination).

The future of DIRECTV's constitutional challenges. Despite DIRECTV's victory, it remains unclear whether the court's decision will ultimately stand. The Florida Supreme Court may overturn the decision (a petition for review has already been filed), and there is an outside chance that the U.S. Supreme Court will eventually address the issue as well.

Over the years, the U.S. Supreme Court has repeatedly declined to hear many of DIRECTV's constitutional challenges. Even in 2012, when it looked as if the Court might grant certiorari in *DIRECTV v. Levin*, 941 N.E.2d 1187 (Ohio 2010), *cert. denied sub nom. DIRECTV v. Testa*, 133 S. Ct. 51 (2012), the Court ultimately declined to hear the case. However, the Court did ask the U.S. Solicitor General to prepare a brief recommending whether to accept the case. Notably, a primary reason the Solicitor General recommended against granting certiorari was because lower courts had not reached conflicting decisions on the issue. Now, with the Florida Court of Appeal's recent decision, that has changed.

DIRECTV has petitions for certiorari pending with the U.S. Supreme Court in both the Tennessee and Massachusetts cases previously cited. The U.S. Supreme Court's recent consideration of other state tax controversies—such as the highly publicized decision in *Comptroller v. Wynne*, 135 S. Ct. 1787 (2015)—indicates that the Court may be willing to accept additional Commerce Clause tax cases.

Although the future of DIRECTV's challenge remains uncertain, the company's Florida victory could provide it with some positive momentum. ■