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NO. 51436-2-II

**COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON**

PEACEHEALTH ST. JOSEPH MEDICAL CENTER, et al.,

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

REPLY BRIEF OF RESPONDENT DEPARTMENT OF REVENUE

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I. INTRODUCTION

The Superior Court correctly concluded the Board of Tax Appeals' interpretation of RCW 82.04.4311 is contrary to the plain language of the statute. By its terms, the statute applies only to the medical assistance and children's health programs authorized "under chapter 74.09 RCW." The legislative history confirms the Legislature intended to create a deduction for amounts public and nonprofit hospitals receive for providing services covered under Washington's Medicaid and CHIP programs.

Rather than giving the plain language its intended effect, the Board erroneously concluded the general legislative findings trump the limitations in the operative statutory provisions and misapplied the last antecedent rule, carving out a deduction broader than the one the Legislature enacted. In trying to justify the Board's erroneous interpretation, PeaceHealth ignores the statute's plain language and misstates its purpose and effect.

PeaceHealth also contends the doctrine of constitutional avoidance compels this Court to affirm the Board's overly broad interpretation in order to save RCW 82.04.4311 from violating the dormant Commerce Clause. It does not. The dormant Commerce Clause does not prohibit a state from using its taxing power to help finance goods or services the state, itself, provides to its citizens. Here, every dollar deducted under

RCW 82.04.4311 is directly related to health care services financed by the federal government or the State of Washington. Under controlling United States Supreme Court precedent, the Legislature was free to provide a tax deduction applicable only to medical services covered under Washington's Medicaid and CHIP programs.

The Superior Court correctly reversed the Board's decision, and this Court should affirm.

II. ARGUMENT

A. The Plain Language of RCW 82.04.4311 Authorizes a Deduction for Providing Services Covered Under Washington's Medicaid and CHIP Programs

By its terms, RCW 82.04.4311 applies to services covered under a medical assistance, children's health, or other "program under chapter 74.09 RCW." PeaceHealth's contention that "medical assistance" and "children's health" are standalone provisions that refer generally to the federal Medicaid and CHIP programs both ignores the plain language of the statute and disregards the basic design of these federal programs.

The federal government does not provide health care coverage to Medicaid or CHIP beneficiaries. Instead, it offers federal funding to the states who wish to establish their own health services programs for the needy. Each state designs, administers, and finances its own Medicaid program, and may then receive federal matching funds in reimbursement.

It is true that RCW 74.09.010(13) defines "medical assistance" as the federal Medicaid program. That statute, however, does not authorize the coverage of any health care services. Instead, it merely explains how that term is being used in RCW 74.09.

The statute that actually authorizes the coverage of health care services is RCW 74.09.500, which provides: "There is hereby established *a new program* of federal aid-assistance *to be known as medical assistance* to be administered by the [Health Care Authority]. The authority is authorized to comply with the federal requirements for Title XIX of Public Law (89-97), as amended, in order to secure federal matching funds for *such program*." (Emphasis added.)

Likewise, RCW 74.09.470(1) directs the Health Care Authority (HCA) to provide "affordable health care coverage to children under the age of nineteen who reside in Washington," and to secure federal funding for "*the state children's health insurance program*" consistent with the requirements of Title XXI of the Social Security Act. (Emphasis added.) The phrase, "medical assistance, children's health, or other program under chapter 74.09 RCW," plainly refers to the medical assistance program, the children's health program, and any other program "under chapter 74.09 RCW."

1. The catchall provision shows that "medical assistance," "children's health," and "other" are part of a unified category of programs

PeaceHealth contends the inclusion of a catchall in RCW 82.04.4311 for any "other" program shows intent to broaden the deduction. Resp. Br. at 9. This is true to the extent the catchall brings into the statute other programs authorized under RCW 74.09 *in addition to* the medical assistance program and the children's health program. For example, the catchall applies to Washington's "medical care services" and "maternity care access" programs, which provide state-funded services for which matching federal funds are not available. *See* RCW 74.09.035 (medical care services), .800 (maternity care access). But the catchall does not expand the scope of the deduction to a medical assistance or children's health program established by any other state.

The Legislature enacted RCW 82.04.4311 "to provide a clear and understandable deduction" for health care services covered under a "qualifying program." Laws of 2002, ch. 314, § 1. The statute serves that purpose by clearly describing the federal Medicare program, the "medical assistance, children's health, or other program under chapter 74.09 RCW," and Washington's Basic Health Plan.

Washington's medical assistance *program* is authorized under RCW 74.09.500; the children's health *program* is authorized under RCW

74.09.470; and other *programs* are authorized under RCW 74.09.800 (maternity care access) and RCW 74.09.035 (medical care services for the aged, blind, or disabled, and lawfully present aliens ineligible for Medicaid). Collectively, these programs make up Washington's Apple Health Program. *See* WAC 182-500-0010 (defining "Apple Health").

The clarity of the phrase, "medical assistance, children's health, or other program under chapter 74.09 RCW" is reinforced by the structure and text of the statute as a whole, including the semicolons bracketing the middle clause and the parallel statutory references to "under Title XVIII," "under chapter 70.47 RCW," and "under chapter 74.09 RCW."

2. The last antecedent rule does not apply because "under chapter 74.09 RCW" has only one antecedent

The Board misapplied the last antecedent rule in concluding that "under chapter 74.09 RCW" applies only to "other program." PeaceHealth's effort to justify the Board's misuse of the rule lacks merit.

PeaceHealth points out that in the part of RCW 82.04.4311 defining who can take the deduction, a comma precedes the phrase, "that qualifies as a health and social welfare organization." Resp. Br. at 11. According to PeaceHealth, this shows the Legislature knew how to use the last antecedent rule, indicating the absence of a comma before "under chapter 74.09 RCW" shows that phrase applies only to the last antecedent.

The flaw in the Board's analysis, which PeaceHealth repeats, was in failing to recognize there was no need for a comma before "under chapter 74.09 RCW" because that phrase has only one antecedent. By contrast, the phrase in the opening part of the statute, "that qualifies as a health and social welfare organization," is preceded by four antecedents (public hospital, nonprofit hospital, nonprofit community health center, network of nonprofit community health centers). Thus, a comma was needed to establish that the modifying phrase applies to all four types of health care facilities, not just the immediately preceding one.

But there was no need to put a comma before "under chapter 74.09 RCW" because the only relevant antecedent is "program," which, itself, is clearly modified by the three preceding coordinating noun adjectives. Coordinate adjectives are two or more adjectives in a row that each separately modifies the noun that follows. Bryan A. Garner, *The Redbook: A Manual on Legal Style* § 1.7 (3d ed. 2013). Under basic rules of grammar, a comma is used to separate coordinate adjectives from one another, but no comma is used between the final adjective and the noun it modifies. *The Chicago Manual of Style* § 6.33 (17th ed. 2018). For example, a high school student might be required to enroll in a "biology, chemistry, or other class in the science department." The words "biology," "chemistry," and "other" are coordinate adjectives describing the types of

classes the student may choose. Likewise, "medical assistance, children's health, or other program under chapter 74.09 RCW" describes the types of programs "under chapter 74.09 RCW" that qualify for the deduction.

The only commas needed for clarity were the ones after "medical assistance" and "children's health," which signal that "other" is part of a series of coordinate adjectives, each of which modifies "program." It then follows that "under chapter 74.09 RCW" applies to all three types of programs. The Legislature did not need to put a comma before "under chapter 74.09 RCW" to connect that phrase to the "medical assistance" or "children's health" program.

3. "Medical assistance" and "children's health" are not standalone provisions

PeaceHealth insists that "medical assistance" and "children's health" are not adjectives modifying "program," but instead standalone references to federal programs. Resp. Br. at 12. But it has no real answer to the Department's argument that the middle clause of RCW 82.04.4311 is most naturally read to mean the medical assistance program and the children's health program "under chapter 74.09 RCW."

Divorcing "children's health" from the word "program" simply makes no sense because money is not received from "children's health," but from a children's health program authorized by a government. And

unlike "medicare," "medical assistance" has no commonly understood meaning standing alone. Why would the Legislature refer to "the federal medicare program *under Title XIV of the social security act*" in RCW 82.04.4311, but not refer to the federal law authorizing Medicaid, if it intended to provide a deduction for all 56 Medicaid programs in the country? PeaceHealth's textual analysis is implausible.

PeaceHealth also contradicts itself by relying on the very statutory provisions "under chapter 74.09 RCW" that it claims are unnecessary to give meaning to "medical assistance" and "children's health." PeaceHealth cites to various statutes that purportedly show these terms refer generically to the federal Medicaid and CHIP programs. What those statutes actually show is that RCW 82.04.4311 applies to health care services authorized under Washington law.

According to PeaceHealth, "chapter 74.09 RCW consistently refers to 'medical assistance' not 'medical assistance program.'" Resp. Br. at 12. But the statutes PeaceHealth cites contradict that assertion. *See* RCW 74.09.500 (establishing "a new *program* of federal-aid assistance to be known as *medical assistance*," and directing HCA "to comply with the federal requirements for the *medical assistance program* ...in order to secure federal matching funds for *such program*" (emphasis added)); RCW 74.09.515(1) (directing HCA to reinstate coverage for recently

released "youth who were enrolled in a *medical assistance program*" before their confinement (emphasis added)); RCW 74.09.5222(1) (directing HCA to apply for a waiver of federal requirements in order "to expand and revise *the medical assistance program*" (emphasis added)). When used as a standalone phrase, "medical assistance" refers to the services covered under Washington's medical assistance program. *See* RCW 74.09.510 (authorizing HCA to provide "[m]edical assistance" to specified categories of persons); RCW 74.09.520(1) ("The term 'medical assistance' may include the following care and services…").

The terms "medical assistance" and "children's health" in the statutes are not standalone references to federal programs. To the contrary, these terms modify the noun "program" and refer to the medical assistance and children's health programs established under RCW 74.09.

4. The legislative findings do not expand the deduction to include health care services provided by other states

The legislative findings do not, as PeaceHealth argues and the BTA concluded, establish legislative intent to provide a deduction for any other state's health care services program. The Legislature found that providing publicly funded health care benefits to the needy is a "vital governmental function," and that it would be inconsistent with that governmental function to tax amounts received by a nonprofit or public

hospital "when the amounts are paid under a health service program subsidized by federal or state government." Laws of 2002, ch. 314, § 1. But the Legislature also stated its intent "to provide a clear and understandable deduction for these amounts." *Id.* It did so by specifically describing the scope of the deduction in sections 2 and 3 of the bill. Section 3 allows a deduction for "amounts received from the United States...or from the state of Washington..." as compensation for providing health or social welfare services. Section 2 allows a deduction for amounts nonprofit hospitals receive for providing health care services covered under a qualifying government program, including the medical assistance or children's health program "under chapter 74.09 RCW."

The BTA erred by inferring the Legislature intended to provide a broader deduction than the one it actually described.

B. Legislative History Shows the Legislature Deliberately Limited the Deduction to Washington's Medicaid and CHIP Programs

If this Court deems the statute ambiguous, the legislative history is relevant in discerning legislative intent. This Court also should accord deference to the Department's interpretation of the statutes it is charged with administering. *Dep't of Revenue v. Nord Nw. Corp.*, 164 Wn. App. 215, 229-30, 264 P.3d 259 (2011). Because RCW 82.04.4311 creates a deduction for otherwise taxable revenues, it must be read "strictly, though

fairly" against the taxpayer. *Group Health Co-op. of Puget Sound, Inc. v. Wash. State Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967).

PeaceHealth incorrectly asserts this Court "should accord substantial weight" to the Board's interpretation of RCW 82.04.4311, but the case it cites for that proposition does not support it. Resp. Br. at 8 (citing *Verizon Nw., Inc. v. Employment Sec. Dep't*, 164 Wn.2d 909, 915, 194 P.3d 255 (2008)). As the agency charged with administering the State's excise tax laws, the Department, not the Board, is entitled to deference. *Nord Nw. Corp.*, 164 Wn. App. at 229-30. *See Port of Seattle v. Pollution Control Hearings Bd.*, 151 Wn.2d 568, 593-94, 90 P.3d 659 (2004) (courts defer to the agency charged with administering a particular statute rather than to a quasi-judicial body). The Department's core duties include advising the Legislature on matters of tax policy, assisting with bill drafting, and preparing fiscal notes. RCW 82.01.060(5). Thus, the Department is in a better position than the Board to understand the legislative intent of the statute, having directly participated in the legislative process leading to the enactment of RCW 82.04.4311.

The legislative history shows the Legislature enacted the statute to fix a specific problem. The problem was in RCW 82.04.4297, which allows a deduction for "amounts received from the United States...or from the state of Washington" for providing health care services, but does not

apply to amounts received from private managed care organizations that provide health care insurance coverage on behalf of the federal or state government. The Legislature enacted RCW 82.04.4311 to allow public and nonprofit hospitals to continue deducting their revenues from services covered under the federal Medicare program and from Washington's Medicaid and CHIP programs after the federal and state governments opted to have managed care organizations procure health care services.[1]

Initially, the Legislature broadened the deduction by amending RCW 82.04.4297 to redefine "received from" as including amounts received from a managed care organization "under contract to manage health care benefits for" the federal Medicare program, Washington's Basic Health Plan, or "a medical assistance, children's health, or other program authorized under chapter 74.09 RCW." Laws of 2001, ch. 23, § 2. PeaceHealth correctly states the Department saw "problems with the bill" and sought to have them addressed during the subsequent legislative session.[2] Resp. Br. at 17. Specifically, the Department was concerned the

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[1] Formerly, Washington only purchased health care on a "fee for service" basis or by contracting directly with hospitals and providers. *See* Laws of 1967, ch. 30, § 1 ("The department shall purchase hospital care by contract or by all inclusive day rate, or at a reasonable cost based on a ratio of charges to cost.").

[2] But contrary to PeaceHealth's innuendo, the Department does not begrudge nonprofit hospitals their entitlement to the deduction provided by RCW 82.04.4311. The Department's duty is to implement the statutes enacted by the Legislature. In administering the state excise taxes, the Department abides by the same principles that guide the courts in matters of statutory interpretation.

2001 legislation would be difficult to administer because hospitals may receive payments from managed care organizations for services other than those financed by the federal or state government. AR 229.

The 2002 legislation resolved that problem by redefining the scope of the deduction as "amounts received *for*" health care services covered under a qualifying government program rather than "amounts received *from*" a managed care organization. Laws of 2002, ch. 314, § 2 (emphasis added). The stated purpose of the 2002 session law was "to provide a clear and understandable deduction" for amounts a public or nonprofit hospital received for services covered under a "qualifying program" and to ensure the deduction does "not depend on whether the amounts are received directly from a qualifying program or through a managed health care organization under contract to manage benefits for a qualifying program." Laws of 2002, ch. 314, § 1. RCW 82.04.4311 serves that purpose by clearly defining the categories of health care providers entitled to take the deduction (public or nonprofit hospitals) and the pertinent qualifying government programs (federal Medicare program and the State of Washington's Medicaid, CHIP, and Basic Health Plan programs).

PeaceHealth focuses on trivial differences between the 2001 and 2002 bills while ignoring the core purpose for the legislation. PeaceHealth makes much of the fact that the article "a" was omitted from the 2002 bill

superseding the initial amendment of RCW 82.04.4297. Resp. Br. at 12-13. That change was inconsequential. It certainly does not show intent to convert "medical assistance" into "a generic word for the federal program," as PeaceHealth contends. Resp. Br. at 12. If anything, the deletion of "a" clarified that the statute applies only to *the* medical assistance program "under chapter 74.09 RCW," rather than to any medical assistance program. *See Hinton v. Johnson*, 87 Wn. App. 670, 675, 942 P.2d 1061 (1997) (courts will construe "a" as applying to the plural as well as the singular absent clear indications of contrary intent).

PeaceHealth asserts the Legislature intended to help hospitals "stretch the monies received" when it enacted HB 2732 in 2002. Resp. Br. at 18. That may be true, but only to the extent of receipts for services actually covered under the programs described in RCW 82.04.4311, which does not include other states' public health care assistance programs.

C. The Board's Decision Usurps the Legislature's Prerogative to Set the State's Tax Policy

Although PeaceHealth tries to defend the Board's erroneous interpretation of RCW 82.04.4311 based on the purportedly plain language of the statute, its real argument is one of policy: "[I]t is implausible that the Washington Legislature was looking to capture tax revenue from the health care services provided at a loss to this indigent

population." Resp. Br. at 21. There are several flaws in this argument.

First, RCW 82.04.4311 did not increase any one's tax liability. It provided relief from otherwise applicable taxes. Second, the Legislature specifically limited the deduction in several ways. It applies only to public or nonprofit hospitals qualifying as a "health or social welfare organization" under RCW 82.04.4311. For-profit hospitals and health care providers do not qualify regardless of whether they, too, provided services at a loss. In addition, the deduction does not apply to amounts public or nonprofit hospitals received for patient copayments or deductibles.

The Legislature chose to tax *all* amounts received by for-profit hospitals and all copayments received by nonprofit and public hospitals for providing services covered under a qualifying program, even if the hospital incurred a loss. Thus, it is not at all implausible the Legislature also intended to tax amounts received for services financed by other states.

Finally, the fact that healthcare services may be provided "at a loss" is an ordinary result of Washington's Medicaid program.[3] *See* AR

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[3] The federal Medicare and Medicaid programs are designed to require the private sector to subsidize the costs of publicly financed health care by capping reimbursement rates on the actual cost of providing services. *See Abraham Lincoln Memorial Hosp. v. Sebelius*, 698 F.3d 536 (7th Cir. 2012) (Medicare and Medicaid programs limit reimbursement to costs "actually incurred" by provider). As a result, health care providers must require private payors to absorb a disproportionate share of their operational expenses in order to earn a margin or make up for gaps between the costs of services and Medicare/Medicaid reimbursement rates. The fact that PeaceHealth incurred a loss in providing services is irrelevant to the question of statutory interpretation at issue.

109-11 (HCA report to the Legislature on the State's Medicaid reimbursement rates as a percentage of hospital costs). It does not provide a rationale for reading the deduction broadly. Each state decides for itself how much to pay in reimbursement for health care services provided to its citizens. If PeaceHealth incurs a loss for services provided to Oregon residents, its complaint is with the State of Oregon. Washington is responsible for ensuring its own Medicaid reimbursement rates are adequate, and providing a tax deduction that reduces the costs of services covered under the State's Medicaid program is one way it does so.

Nothing prevents PeaceHealth from demanding higher reimbursement rates from another state as a condition for providing services. Apart from certain emergency services (which every hospital in the country is required to make available under federal law without regard to a patient's ability to pay), PeaceHealth is free to demand a higher reimbursement rate as a condition to providing services covered by other states. *See Asante v. Calif. Dep't of Health Care Servs.*, 886 F.3d 795, 801 (9th Cir. 2018) ("the Hospitals are not required to participate in the Medi-Cal insurance program; no hospital is"). PeaceHealth's broad assertion that "Washington hospitals may not discriminate against Medicaid enrollees from other states" is unsupported by the federal regulation it cites. Resp. Br. at 20. That regulation, 42 CFR § 431.52, merely requires

that a state cover services its residents receive while traveling out-of-state under limited circumstances (e.g., medical emergencies).[4]

PeaceHealth also argues, to no effect, that RCW 82.04.4311 has no impact on Medicaid reimbursement rates. It does not matter whether the deduction directly impacts Washington's (or any other state's) Medicaid reimbursement rates. Each state is responsible for designing, administering, and financing its own Medicaid program for the benefit of its own citizens. This is reason enough to explain why the Legislature would limit the deduction to Washington's Medicaid program.

The B&O tax is part of the cost of doing business in Washington. Absent a statutory exception, every healthcare provider in Washington pays B&O tax on every dollar it receives in compensation for providing health care services. As it relates to this case, the purpose and effect of RCW 82.04.4311 is simply to reduce a public or nonprofit hospital's costs of providing health care services covered under the state-funded health services programs established under Washington law.

Every dollar deducted under RCW 82.04.4311 is a dollar saved by the hospital that provided the service and spent by the State of

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[4] If anything, the regulation shows that Washington hospitals are free to challenge the adequacy of the reimbursements rates paid by other states. *See Mary Hitchcock Memorial Hospital v. Cohen,* No. 15-cv-453-LM, 2016 WL 1735818 (D.N.H. 2016) (allowing Vermont hospital to challenge adequacy of rates paid by New Hampshire as contrary to 42 CFR § 431.52).

Washington. The Legislature was free to use its taxing power to help procure health care services for its residents, and it was not obligated to provide a tax deduction for expenditures made by any other state.

Contrary to PeaceHealth's efforts to portray the Department as an opponent of tax breaks for nonprofit hospitals, the Department takes no position on whether it would be good tax policy for the Legislature to extend the deduction to amounts public or nonprofit hospitals receive for providing health care services financed by other states. But that is not the policy enacted in RCW 82.04.4311. The Board usurped the Legislature's prerogative to set the State's tax policy by expanding the deduction in RCW 82.04.4311 beyond its clear scope.

D. RCW 82.04.4311 Does Not Implicate Dormant Commerce Clause Concerns Because It Does Not Discriminate Against Interstate Commerce

PeaceHealth complains the Department has given "short shrift" to its argument that RCW 82.04.4311 must be read liberally to avoid running afoul of the dormant Commerce Clause. Resp. Br. at 25. If so, that is because both the text of the statute and controlling precedents are clear, and neither supports PeaceHealth's argument.

Washington courts will not rewrite an otherwise clear statute under the guise of saving it from unconstitutionality. *See Wash. State Republican Party v. Pub. Disclosure Comm'n,* 141 Wn.2d 245, 281-82, 4 P.3d 808

(2000) (declining to imply an exemption for issue advocacy to save a campaign finance law from violating the first amendment). The plain language of RCW 82.04.4311 clearly limits its scope. But even if the statute reasonably could be read as applying to any other state's Medicaid or CHIP program, there is no need to so do. Reading RCW 82.04.4311 "strictly, though fairly" as applying to the programs established under Washington law does not raise dormant Commerce Clause concerns.[5]

The dormant Commerce Clause is aimed at preventing the states from "impeding free private trade in the national marketplace." *Reeves, Inc. v. Stake*, 447 U.S. 429, 436-37, 100 S. Ct. 2271, 65 L. Ed. 2d 244 (1980). But absent congressional action, the Commerce Clause does not prohibit a state "from participating in the market and exercising the right to favor its own citizens over others." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810, 96 S. Ct. 2488, 49 L. Ed. 2d 220 (1976). Furthermore, the dormant Commerce Clause does not prevent a state from using its taxing power or regulatory authority to favor the state itself, or its citizens, in fulfilling its traditional governmental functions. *See Dep't of Revenue of Kentucky v. Davis*, 553 U.S. 328, 128 S. Ct. 1801, 170 L. Ed. 2d 685 (2008) (affirming Kentucky's right to tax interest earned on out-of-state

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[5] *See Group Health Co-op of Puget Sound, Inc. v. Wash. State Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967) (ambiguous tax deductions must be strictly construed against the taxpayer).

bonds while exempting interest earned on locally issued bonds); *White v. Massachusetts Council of Const. Employers, Inc.*, 460 U.S. 204, 209, 103 S. Ct. 1042, 75 L. Ed. 2d 1 (1983) (affirming an executive order requiring public construction contractors to hire city residents).

The Supreme Court evaluates discriminatory measures favoring public entities differently from those favoring private interests for purposes of the dormant Commerce Clause. The precursor to any discrimination claim is the existence of a class of similarly situated entities. *General Motors Corp. v. Tracy*, 519 U.S. 278, 298, 117 S. Ct. 811, 136 L. Ed. 2d 761 (1997). A state's obligation to protect public health, safety, and welfare sets the state apart from both private actors and other state governments. *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 342-43, 127 S. Ct. 1786, 167 L. Ed. 2d 655 (2007). Thus, laws that favor the government in exercising its traditional government functions, but treat every private business, whether in-state or out-of-state, the same, do not discriminate against interstate commerce for purposes of the dormant Commerce Clause. *Id.* at 334 (affirming a "flow control ordinance" that disadvantaged out-of-state businesses by requiring all trash haulers to deal exclusively with a state-owned processing facility).

For example, having decided to pay a bounty to subsidize the costs of removing junk cars from city streets, Maryland was free to make it more difficult for out-of-state processors than for in-state processors to claim the bounty. *Hughes*, 426 U.S. at 809-10. The Supreme Court held that the discriminatory treatment of out-of-state processors was not subject to scrutiny under the dormant Commerce Clause. *Id.*

In *Reeves*, the Supreme Court affirmed South Dakota's right to restrict the sale of cement produced at a state owned factory to its own residents in times of scarcity. The Court rejected the argument that the dormant Commerce Clause prohibited the State from discriminating against out-of-state buyers, stating the "residents only" policy reflected "the essential and patently unobjectionable purpose of state government—to serve the citizens of the State." *Reeves*, 447 U.S. at 442.

Peacehealth erroneously claims the "controlling precedent" is *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me.*, 520 U.S. 564, 575-76, 117 S. Ct. 1590, 137 L. Ed. 2d 852 (1997). That case involved a property tax exemption Maine offered to charitable organizations that primarily provided services, such as summer camps, to state residents. In a 5 to 4 decision, the court struck down the exemption as impermissibly discriminatory against out-of-state residents.

Camps Newfound is factually distinguishable because the State in that case was not acting as a market participant at all, but nevertheless tried to equate a property tax exemption with "participation" in the market. Still, the four dissenters in *Camps Newfound* would have affirmed the tax exemption as functionally equivalent to a subsidy for public goods or services the State might otherwise have provided for the benefit of its residents, and thus exempt from dormant Commerce Clause scrutiny. But the majority rejected that argument because it viewed the link between the tax exemption and the State's provision of public goods or services as too attenuated to be analogized to the State's participation in a discrete sector of the economy, such as auto salvaging, cement production, or public construction, which the Court had upheld in *Hughes*, 426 U.S. 794, *Reeves*, 447 U.S. 429, and *White*, 460 U.S. 204, respectively.

The property tax exemption at issue in *Camps Newfound* was untethered to the State's participation in any market. In contrast, the deduction in RCW 82.04.4311 goes hand in hand with the State's provision of public goods and services. The deduction is a quid pro quo for providing services covered under Washington's Apple Health program. Every dollar deducted is directly tied to health care services authorized and funded by the State of Washington. The deduction is a permissible subsidy of Washington's Apple Health program, and the

market participant exception applies.

There can be no serious doubt that Washington is acting as a market participant in procuring health care services for its residents. *See Asante*, 886 F.3d at 801 (in procuring health care services for beneficiaries of the Medi-Cal program, California acts "much like that of a private insurer participating in the market"). Nearly one-third of Washington's total budget goes to the cost of state-purchased health care. Laws of 2011, 1st Spec. Sess., ch. 15, §1(2). Nevertheless, PeaceHealth argues there is a "critical difference" between limiting state-funded health care services to Washington residents and limiting the deductibility of a hospital's receipts for such services. Relying on *Camps Newfound*, PeaceHealth argues that the assessment and collection of taxes is a "primeval government activity" that falls outside the market-participation doctrine. Resp. Br. at 35 (quoting *Camps Newfound*, 520 U.S. at 593).

In *Davis*, which was decided more than a decade after *Camps Newfound*, the Supreme Court rejected the very same argument, stating it "would require overruling most, if not all, of the cases on point" decided since 1976. *Davis*, 553 U.S. at 345. A long line of Supreme Court precedents has affirmed the right of the states to exercise their taxing power and regulatory authority to set the terms and conditions for their own participation in a market. *See Davis*, 553 U.S. at 344-45, 347

(summarizing the market participant doctrine as prohibiting the states from enacting discriminatory measures that create "a commercial advantage for goods or services marketed by local private actors," while leaving the states free to enact discriminatory measures that favor "the government and those they employ" in fulfilling their civic objectives).[6]

The *Davis* court had no trouble sustaining Kentucky's decision to provide a tax deduction for interest paid on bonds issued by local governments, while taxing the interest paid by out-of-state bond issuers. 553 U.S. 328. The Supreme Court distinguished *Camps Newfound* on the ground that the discriminatory tax measure at issue in that case involved "market regulation without market participation." *Id.* at 347-48. In contrast, the State of Kentucky was acting in a *dual role* as market regulator and market participant by providing a tax deduction tied to the state's participation in the bond market. *Id.* at 348.

In *Davis*, the Supreme Court also made it clear the *Pike* balancing test has no place in cases involving a state tax exemption tied to the State's provision of public goods or services. *Id.* at 354-56 (discussing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 90 S. Ct. 844, 25 L. Ed. 2d 174 (1970)).

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[6] *See* Daniel R. Ray, "*Cash, Trash, and Tradition: A New Dormant Commerce Clause Exception Emerges From United Haulers and Davis*," 61 Tax Law. 1021 (2008) (in-depth discussion of how the Supreme Court broadened the market participant rule by allowing the states to exercise their taxing power and regulatory authority as an adjunct to market participation in performing traditional government functions).

In declining to apply *Pike*, the Court explained that the judiciary branch is ill equipped to weigh the costs and benefits of state tax measures tied to market participation. *Davis*, 553 U.S. at 354-56. No sound basis exists for this Court to second-guess the Legislature's decision to provide a tax deduction for public and nonprofit hospitals participating in Washington's Medicaid Program.

Consistent with *Davis*, the Legislature was free to provide a tax deduction applicable only to the publicly funded health services programs established by the State of Washington.

III. CONCLUSION

The Board's overly broad interpretation of RCW 82.04.4311 is neither consistent with the plain language of the statute nor compelled by the doctrine of constitutional avoidance. The Superior Court correctly reversed the Board and remanded with instructions to grant summary judgment to the Department. This Court should affirm the Superior Court.

RESPECTFULLY SUBMITTED this 7th day of September, 2018.

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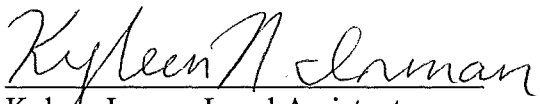
I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 7th day of September, 2018, at Tumwater, WA.



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