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THE DORMANT COMMERCE CLAUSE: ADOPTING A NEW STANDARD AND A RETURN TO PRINCIPLE

Timothy J. Slattery*

INTRODUCTION

In one of the more controversial terms for the Supreme Court—adjudicating cases about sentencing guidelines,[1] gun control laws,[2] and the constitutionality of lethal injection[3]—a small case out of a Kentucky appeals court will likely have the largest influence on our everyday lives. George and Catherine Davis, a couple from Kentucky, filed suit against the State for the disparate tax treatment of in-state and out-of-state municipal bonds, implicating the Dormant Commerce Clause.[4] In a multi-trillion-dollar market, any small movement has massive implications,[5] but foundational changes have profound effects across the entire economy. With an economy concerned about economic stimulus packages, falling interest rates, collapsing financial institutions, and the subprime mortgage crisis,[6] it is distressing to imagine the challenges the economy would face if the municipal bond market adjusted to the changing tax treatment.

This Note will examine current Dormant Commerce Clause doctrine in the context of the Court's latest decision, *Department of Revenue of Kentucky v. Davis*. Through its decisions regarding the Dormant Commerce Clause, the Supreme Court has continually created more confusion and uncertainty. Beginning with distinctions such as whether the statute in question is economically protectionist and continuing to whether the benefits accrue to public or private entities, the current doctrine is a veritable chaotic collection of doctrine with little cohesion between decisions. This Note analyzes current Dormant Commerce Clause doctrine and proposes a new standard for deciding such challenges with more principle, precision, and predictability.

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* J.D., William & Mary School of Law, 2009; B.A., College of William & Mary, 2006. I wish to thank my editor for helping me throughout the process and for never doubting me. I also wish to thank my family and friends for always providing the support, love, and encouragement I need—I owe each of you a tremendous amount.

[1] Kimbrough v. United States, 128 S. Ct. 558 (2007).

[2] District of Columbia v. Heller, 128 S. Ct. 2783 (2008).

[3] Baze v. Rees, 128 S. Ct. 1520 (2008).

[4] Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801 (2008).

[5] Tom Herman, *Tax Report: Kentucky Suffers Setback in Muni-Bond Tax Case*, WALL ST. J., Sept. 6, 2006, at D2.

[6] *See* Sarah Lueck et al., *Default Fears Unnerve Markets: Bush, Democrats Rush to Roll Out Stimulus Plan*, WALL ST. J., Jan. 18, 2008, at A1.

Part I discusses the background to the principal case, including the statutory background in *Davis* and its pervasiveness throughout the country. Part II reviews a brief history of municipal fundraising, including benefits, purposes, and expansion of the municipal bond market, to provide a context for the extent of the markets and the widespread effect of *Davis*. Part III scrutinizes current Dormant Commerce Clause doctrine, including the distinctions, categorizations, and exceptions—all of which haphazardly flood a muddied field of constitutional law. Part IV proposes a new standard for the Supreme Court to adopt in its analysis of Dormant Commerce Clause challenges, including policy and constitutional reasons for adopting the standard. Part IV also analyzes past precedent in light of the proposed standard, finding that much of the current doctrine fits into the strict scrutiny framework. Part V returns to the *Davis* case, considers lessons learned from past precedent under the new standard, and applies the new standard to the facts in *Davis*. This Note concludes that the best way to approach Dormant Commerce Clause cases is through adoption of strict scrutiny as a uniform standard.

I. BACKGROUND TO *DAVIS*

Municipal bond issues, aside from taxes, are a predominant method for states and localities to raise much-needed funds for local public works projects and other area requirements. With the advent of "triple tax exemption" from federal, state, and city taxes, municipal bonds are a $2.3 trillion market.[7] The tax exemption provides incentive for residents to invest in municipal bonds and promote local projects.[8] Their increasing prevalence to raise funds for local needs led to special tax treatment at both the federal and state levels.[9]

Kentucky Revised Statutes govern individual state income taxes on net income, which is determined after deductions from an individual's adjusted gross income.[10] Kentucky's statute includes "interest income derived from obligations of sister states and political subdivisions thereof" in its definition of adjusted gross income, but importantly, not interest income from obligations of Kentucky and its political subdivisions.[11] The statute, in conjunction with the other definitions of adjusted gross income, effectively exempts in-state municipal bonds while taxing their out-of-state counterparts.

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[7] *See* Herman, *supra* note 5. State and local governments increasingly use municipal bonds to raise funds without increasing the state tax burden. State and local governments issued over $350 billion from 2002 to 2006. Linda Greenhouse, *Supreme Court to Address State Tax Breaks for Bonds,* N.Y. TIMES, May 22, 2007, at C3.

[8] *See* Herman, *supra* note 5.

[9] *See infra* notes 11–15 and accompanying text.

[10] KY. REV. STAT. ANN. § 141.010(11) (West 2006). Adjusted gross income is found by taking deductions from gross income, as defined by the IRS. I.R.C. § 62 (2006). The definition of gross income does not include interest on state or local bonds. I.R.C. § 103 (2006).

[11] KY. REV. STAT. ANN. § 141.010(10)(c) (West 2006).

Most states across the country have provisions similar to those enacted by Kentucky.[12] Virginia, for instance, uses as its adjusted gross income the gross income under federal taxes, yet explicitly requires "obligations of any state other than Virginia" be added back into the calculation.[13] Similarly, Massachusetts requires out-of-state bonds to be included in their determination of adjusted gross income.[14] New York, which is at the center of the secondary securities market in municipal bonds, also provides tax exemption for its own bonds while taxing bonds from other states.[15] Not only would the effects of overturning such a taxation scheme affect cities and states, but also it would have far-reaching effects on the health of the municipal bond securities markets.[16]

That tax treatment incites debate over its constitutionality, in particular, whether it violates the Dormant Commerce Clause. The only case to broach the subject in recent memory is *Davis v. Department of Revenue of Kentucky*.[17] George and Catherine Davis, residents of Kentucky, owned municipal bonds issued in Kentucky, as well as municipal bonds issued outside the state.[18] The couple sought a declaratory judgment alleging that the tax treatment violates the Commerce Clause and the Equal Protection Clause by discriminating based on the bonds' origins.[19] The Kentucky appellate court, in a concise opinion, held the system to be "facially unconstitutional as it obviously affords more favorable taxation treatment to in-state bonds than it does to extraterritorially issued bonds."[20] The court reasoned that the Ohio appellate court did not sufficiently support its decision in *Shaper v. Tracy* with analysis to uphold a similar taxation scheme.[21] Furthermore, the Kentucky court also dismissed arguments under the Full Faith and Credit Clause[22] and the market participant doctrine, ultimately

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[12] *See, e.g.*, DEL. CODE ANN. tit. 30, § 1106(a)(1) (2009) ("There shall be added to federal adjusted gross income: [i]nterest . . . other than interest on obligations and securities of this State . . . . "); D.C. CODE § 47-1803.02(a)(1) (2006 & Supp. 2008) ("[T]he following items shall also be included . . . in the computation of District gross income: [i]nterest upon the obligations of a state, territory of the United States, or any political subdivision thereof, but not including the District of Columbia . . . . "); MICH. COMP. LAWS ANN. § 206.30(1)(a) (2009) ("Add gross interest income and dividends derived from obligations or securities of states other than Michigan . . . . "); OHIO REV. CODE ANN. § 5747.01(A)(1) (West Supp. 2006) ("Add interest or dividends on obligations or securities of any state or of any political subdivision or authority of any state, other than this state and its subdivisions and authorities.").

[13] VA. CODE ANN. § 58.1-322(B)(1) (2004).

[14] MASS. GEN. LAWS ANN. ch. 62, § 2(a)(1)(A) (West Supp. 2008).

[15] N.Y. TAX LAW § 612(b)(1) (McKinney 2008).

[16] *See* Herman, *supra* note 5.

[17] 197 S.W.3d 557 (Ky. Ct. App. 2006), *rev'd*, 128 S. Ct. 1801 (2008).

[18] *Id.* at 560.

[19] *Id.*

[20] *Id.* at 562.

[21] 647 N.E.2d 550 (Ohio Ct. App. 1994), *cert. denied*, 516 U.S. 907 (1995).

[22] *Davis*, 197 S.W.3d at 563–64 (distinguishing *Bonaparte v. Tax Court*, 104 U.S. 592 (1881), on grounds that the Commerce Clause was not implicated in *Bonaparte*, and the Full Faith and Credit Clause was not at issue in *Davis*).

finding for the Davises.[23] The Supreme Court, on the other hand, easily dismantled the Kentucky appellate court's reasoning, stating that *Davis* was closest akin to *United Haulers*, in that the tax scheme favored a traditional government function without any differential treatment favoring local entities over substantially similar out-of-state interests.[24] The quintessential public function of issuing bonds under the *United Haulers* standard was sufficient to move Kentucky's differential taxation scheme out from under Dormant Commerce Clause scrutiny.[25]

II. HISTORICAL OVERVIEW OF MUNICIPAL FUNDRAISING

A. Traditional Methods of Fundraising

Since cities and states first began organizing in the late 1600s and early 1700s, municipal fundraising at both a state and local level existed.[26] Primarily through taxes, cities and states were able to raise funds necessary to support education, train armed militias, develop forms of social insurance, and benefit the public at large.[27] Over time, more public works projects developed and governments sought evolving ways of addressing their financing needs.[28] City and state spending comes in two variations: operating expenses, which are covered by tax revenues, and capital expenditures, which are financed by issuing municipal bonds.[29] As the demand for larger scale capital improvements increased, borrowing from banks, increased tax collections, and public land sales were less and less adequate.[30] Soon after, cities and states began to issue municipal bonds as a way of raising the funds necessary for the capital projects.[31]

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[23] *Id.* at 564 (stating the taxation and not issuance was at issue, the computation of taxes is clearly "'a primeval governmental activity,'" and thus the State is a market regulator (quoting New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 277 (1988))).

[24] Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801, 1811 (2008) ("Thus, *United Haulers* provides a firm basis for reversal.").

[25] *Id.*

[26] Gordon L. Calvert, *Development, Volume, Purchasers and Ratings*, *in* FUNDAMENTALS OF MUNICIPAL BONDS 15, 16 (Gordon L. Calvert ed., 1959); *see also* Craig Johnson & Marilyn Manks Rubin, *The Municipal Bond Market: Structure and Changes*, *in* HANDBOOK OF PUBLIC FINANCE 483, 485 (Fred Thompson & Mark T. Green eds., 1998).

[27] Calvert, *supra* note 26, at 15.

[28] *Id.* at 15–16.

[29] *Id.* at 15.

[30] *Id.*

[31] *Id.* at 15–16. Some scholars argue it was implicit in the decision in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), that municipal bonds were exempt from federal taxation, suggesting there was already a burgeoning market at the time of the decision. ROBERT LAMB & STEPHEN P. RAPPAPORT, MUNICIPAL BONDS 4–5 (2d ed. 1987).

B. United States Municipal Bond Market

Issuing municipal debt became particularly important as a means to expand the nation's transportation systems to promote the industrializing economy.[32] Nearly all of the early bond issues went to build canals, create a more integrated network of railroads, and develop more efficient roads.[33] By 1843, there was a total of $232 million in municipal debt outstanding, soon ballooning to $1.63 billion outstanding in 1902—representing growth of more than 600%.[34] The purpose for municipal bonds extended beyond transportation, education, utilities, and government buildings.[35] As demand for public services increased, so too did the variety of public purposes. From airports and sports stadiums to golf courses and parks, municipal issues vastly expanded to match an exploding demand for public projects.[36]

The municipal bond market continues to steadily grow and adapt to the changing public needs. As automobiles became more prevalent, the standard of living and the labor force increased in the early 1900s, and so too did the use of municipal debt to finance public projects.[37] This continued through World War II and on into the 1970s.[38] In 1975, municipalities issued $26 billion,[39] soon expanding to over $263 billion by 1999, an increase of nearly 915% in twenty-four years.[40] This expansive growth resulted in over $2.09 trillion outstanding in municipal debt in 2005 to finance various public projects.[41]

Aside from the growth in size of the market, municipalities have also become more savvy as it comes to the type, structure, and development of their bond issues. The term to maturity, structure of repayment, varying interest rates, and compounding of interest all followed trends in the corporate securities markets.[42] One example is zero coupon bonds, which defer semi-annual interest payments to the bonds' maturity, thus reducing the current and near-term liability, but requiring a larger long-term

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[32] Calvert, *supra* note 26.

[33] *Id.*

[34] *Id.*

[35] *Id.* at 16–17.

[36] *Id.* at 17. Between 1946 and 1958, municipal bond use escalated nearly seven-fold from $1.2 billion to more than $7.4 billion. *Id.* at 20.

[37] *Id.* at 16.

[38] *Id.*

[39] JUDY WESALO TEMEL, THE BOND MKT. ASS'N, THE FUNDAMENTALS OF MUNICIPAL BONDS 3 (5th ed. 2001).

[40] *Id.*

[41] U.S. CENSUS BUREAU, GOV'TS DIV., TABLE 1: STATE AND LOCAL GOVERNMENT FINANCES BY LEVEL OF GOVERNMENT AND BY STATE: 2004–05 (2007), *available at* http://www.census.gov/govs/estimate/0500ussl_1.html.

[42] *See* Alan Walter Steiss, *New Financing Instruments for State and Local Capital Facilities,* PUB. BUDGETING & FIN., Fall 1998, at 24.

balloon payment.[43] Municipalities also responded to volatile interest rates by issuing tax-exempt bonds with a floating interest rate to reduce the risk of depleting value to issuers and purchasers alike.[44] These adaptations to the ever-present changes in the market have continued to make municipal bonds an attractive investment for individual and institutional investors.[45]

C. Purposes of Municipal Bonds

Adaptations to the market for municipal bond issues mainly derived from increased need for funding and the new variety of purposes. States and localities traditionally used municipal funding to support public transportation, though that purpose has become a minor use.[46] Development and upgrading of public utilities, healthcare facilities, student loans, capital and economic improvements such as waterfront restoration, and housing structures have all recently been funded by municipal debt.[47] One example of the expanding purposes is the issuance of bonds in Louisiana following Hurricane Katrina. Louisiana congressional members sought more than $30 billion in tax-exempt bonds to rebuild the gulf coast and New Orleans.[48] The bond issue was to benefit local business, redevelop infrastructure, and rebuild the devastated gulf coast region.[49]

In Virginia, education reforms and developments became the purpose of a recent bond issue. Under voter referendum in November 2002, voters in Virginia approved a $900 million bond issue aimed at improving the College of William & Mary's law library, expanding a cancer treatment center at Virginia Commonwealth University, constructing a new arts and sciences building at the University of Virginia, and a biology building at Virginia Tech.[50] Virginia issued its bonds to provide funding for the state-sponsored educational facilities to support their pedagogical objectives.[51] The State also sought to make Virginia public education more competitive with public and

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[43] *Id.* at 29.

[44] *Id.* at 32–33.

[45] *Id.* at 24.

[46] *See* TEMEL, *supra* note 39, at 53–54.

[47] *Id.* During 1999, 22.2% of proceeds of municipal debt supported education at various levels. *Id.*

[48] Christine Richard & Tom Sullivan, *Louisiana Asks Approval to Issue $30 Billion in Tax-Free Bonds,* WALL ST. J., Sept. 23, 2005, at C4. The bonds to be issued were not municipal bonds, but were to be issued by corporations with tax-exempt status. *Id.* Upon review, President Bush opposed the bailout on grounds that the U.S. would not assume debt, but would rather provide tax relief and business loans to invest in the region and create local jobs. Rob Wells, *White House Opposes Muni-Bond Bailout,* WALL ST. J., Oct. 7, 2005, at C4.

[49] *See* Richard & Sullivan, *supra* note 48.

[50] Jeff E. Schapiro, *Casteen Makes Case for Turnout on Bond Issue,* RICHMOND TIMES-DISPATCH, Nov. 3, 2002, at C1.

[51] *Id.*

private schools across the country, especially as education becomes more technology based.[52] The Virginia issue provides an example of the changing landscape in purposes for municipal financing.

D. Benefits of Municipal Bonds

Beyond the uses and purposes of municipal bond issues, public debt financing increased, in part, because the benefits are wide ranging and significant across many parties. Local states, cities, and towns benefit from lower borrowing costs while citizens benefit from tax exemption.[53] Improving state facilities and services tends to increase the quality of public education, healthcare, and other amenities.[54] The injection of government spending and private investment into the economy, moreover, provides essentially riskless investments and a large infusion of public spending to bolster an otherwise struggling economy.[55]

The primary benefit of issuing municipal bonds is that it lowers the borrowing costs to municipalities.[56] Various econometric studies demonstrate the effect that such tax differentials and exemptions have upon the local borrowing costs.[57] States and localities are able to issue debt at lower costs, meaning a lower interest expense burden as the bonds come due.[58] From another perspective, the lower borrowing costs allow the State or locality to issue more bonds, collect more net proceeds, and initiate more public works projects for the same cost. For example, if borrowing costs were reduced by two percent on a $100 million issue, that saves the locality $2 million and allows the savings to be spent on other public works projects, such as capital improvements to educational facilities. Municipalities are able to reduce their interest burden through the state tax treatment of the bond interest income to investors.[59]

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[52] *Id.*

[53] *See generally* Mary E. Lovely & Michael J. Wasylenko, *State Taxation of Interest Income and Municipal Borrowing Costs*, 45 NAT'L TAX J. 37 (1992) (discussing the effect of state exemption of municipal bond interest on the yield to maturity offered by public issuers to finance their debt).

[54] *See* ROBERT H. FRANK & BEN S. BERNANKE, PRINCIPLES OF ECONOMICS 399–473 (3d ed. 2007).

[55] *See id.* at 399–473, 555–85.

[56] *See* Lovely & Wasylenko, *supra* note 53, at 47 ("These estimates provide strong evidence that the widespread practice of exempting residents from state personal income tax on in-state municipal bond interest income significantly reduces municipal borrowing costs.").

[57] *See id.* ("For the tax variables, the model suggests that higher tax rates on out-of-state municipal bond interest income and lower tax rates on in-state municipal bond interest income will lower borrowing costs for in-state issuers."); *see also* David S. Kidwell et al., *The Impact of State Income Taxes on Municipal Borrowing Costs*, 37 NAT'L TAX J. 551 (1984).

[58] *See* Lovely & Wasylenko, *supra* note 53, at 48.

[59] *See id.* at 47.

The benefits of municipal fundraising also extend to the citizens by reducing their tax burden from investments and aiding in economic recovery. A personal investment portfolio with only corporate bond investments pays tax at the prevailing tax rate on the interest received from those investments.[60] In 2007, a single individual with taxable income from employment over $77,100 paid twenty-eight percent tax on each dollar earned from employment, dividends, and corporate bond interest above that income level.[61] Conversely, an individual in the same tax bracket with a pure municipal bond portfolio would not see his portfolio affect his taxable income and his tax burden. The individual investor reduces his tax burden through investment in municipal bonds. Indirectly, this also benefits the municipalities by creating stronger incentives for local investment. Municipal fundraising has also been used in times of dire economic conditions.[62] The injection of government spending into a floundering economy provides a local boost to production and income, causing increases in demand and supporting a local economic recovery.[63] Reducing individual tax burdens and aiding economic growth provide two significant benefits of municipal issues.

While municipal bonds have been a predominant method of raising funds for capital projects at previously unimagined interest costs, they have also become an important part of diversification and risk management in current investor portfolios.[64] As the market continues to expand and embrace municipal offerings, financing becomes more readily available for States and localities—primarily due to their favorable tax treatment across jurisdictions. Moreover, recent constitutional challenges to tax treatment schemes leave investors uncertain as to the stability of the market.

III. DORMANT COMMERCE CLAUSE OVERVIEW

The Commerce Clause expressly grants Congress the power to enact legislation affecting commerce "among the several states"[65] and implicitly creates a prohibition

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[60] I.R.C. § 61(a)(4) (2006).

[61] Internal Revenue Service, 2007 Federal Tax Rate Schedules, http://www.irs.gov/formspubs/article/0,,id=164272,00.html (last visited Mar. 25, 2009); *see also* 26 U.S.C. § 61(a)(4), (a)(7) (2006) ("[G]ross income means all income from whatever source derived, including (but not limited to) the following items: [i]nterest; [d]ividends; . . . .").

[62] *See* Michael A. Pollock, *Municipal-Bond Sales Head for Record Territory as State, Local Governments Tackle Budget Gaps*, WALL ST. J., Dec. 11, 2001, at C12.

[63] Though there is concern over crowding out, which explains why government spending increases cause a nearly identical reduction in private investment in the long run, those effects are not felt initially and perhaps hardly at all as long as municipal bond issues are not regular, consistent, or overwhelmingly large. A discussion of crowding out is better left to economists. *See* FRANK & BERNANKE, *supra* note 54.

[64] For an example of a proposed portfolio, see OppenheimerFunds, Municipal Bond Funds, https://www.oppenheimerfunds.com/investors/education/municipalBondFunds.jhtml (last visited Jan. 27, 2009).

[65] U.S. CONST. art. I, § 8, cl. 3.

on states from creating legislation discriminating against interstate commerce.[66] The implication is that a state cannot prohibit, restrict, or discriminate against products from other states. Michigan, for example, cannot enact legislation prohibiting importation of buckeyes from Ohio. The prohibition mainly rests upon arguments that the Constitution vests Congress with exclusive dominion over regulation of commerce;[67] however, policy arguments further suggest the need to develop national markets[68] and encourage interstate commerce through uniform regulation.[69]

It is uncertain from where exactly the negative aspect of the Commerce Clause derives, though there are certainly traces in the development and text of the Constitution and early cases.[70] In *Gibbons v. Ogden*, for example, the Court emphasized that the power to regulate commerce, "like all others vested in Congress, is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations."[71] Justice Marshall suggested that the power of Congress to regulate commerce is complete and cannot be infringed by the states, implicitly arguing that states are precluded from regulating interstate commerce.[72] As the dormant aspect of the Commerce Clause came to the foreground, principled intention gave way to categorical distinctions, which only served to muddy the standard over the past hundred years. As discussed in the next section, today's jurisprudence reflects no coherent standard for cases arising under the Dormant Commerce Clause.

A. Public/Private Distinction

One recent addition to the categorical distinctions is the public and private nature of the protected entity.[73] After *United Haulers Ass'n v. Oneida-Herkimer*, the Court's Dormant Commerce Clause jurisprudence essentially turns on a significant distinction: whether the law favors local government.[74] According to the Court in *United Haulers*,

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[66] Case of the State Freight Tax, 82 U.S. (15 Wall.) 232 (1872).

[67] *See* Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).

[68] Gen. Motors Corp. v. Tracy, 519 U.S. 278, 299 (1997) (stating that the "dormant Commerce Clause's fundamental objective" was in "preserving a national market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors").

[69] For an interesting discussion on the game theoretical implications of the Dormant Commerce Clause, see Maxwell L. Stearns, *A Beautiful Mend: A Game Theoretical Analysis of the Dormant Commerce Clause Doctrine*, 45 WM. & MARY L. REV. 1 (2003).

[70] *See, e.g.*, U.S. CONST. art. I, § 10; *Gibbons*, 22 U.S. (9 Wheat.) 1.

[71] *Gibbons*, 22 U.S. (9 Wheat.) at 196.

[72] *Id.*

[73] First Amendment jurisprudence provides an analogy to the public/private distinction embraced in Dormant Commerce Clause doctrine. *See, e.g.*, Se. Promotions, Ltd. v. Conrad, 420 U.S. 546 (1975) (holding that a municipal auditorium was a public forum and speech was protected under the First and Fourteenth Amendments).

[74] 127 S. Ct. 1786, 1795–96 (2007).

"it does not make sense to regard laws favoring local government and laws favoring private industry with equal skepticism."[75] As a result, the Court applied a softer standard to the ordinance put forth in *United Haulers*, requiring only a *Pike*-test analysis, because it was favoring a publicly created corporation for the benefit of the locality.[76] Had the law favored in-state over out-of-state private enterprise, the Court would have applied the standard applicable under *City of Philadelphia v. New Jersey*, which addresses concerns of economic protectionism.[77] In adopting the analysis in *United Haulers*, the Court in *Davis* held that the state tax scheme and corresponding issuance of bonds was favoring local government, rather than private industry, which led solely to *Pike*-test analysis.[78]

The standard in *United Haulers* notes that laws favoring local government are treated with less scrutiny than those favoring private industry, provided the law favoring local government treats all private business, whether in-state or out-of-state, identically.[79] In *United Haulers*, all private waste carriers, whether local or interstate, were required to deliver solid waste generated within the counties to the public processing site.[80] In that case, Chief Justice Roberts, speaking for the Court, utilized the *Pike* test.[81] The *Pike* test applies to laws "directed to legitimate local concerns, with effects upon interstate commerce that are only incidental."[82] The test first must ascertain whether the law was directed at a legitimate local concern and then whether the burden imposed on interstate commerce is clearly excessive compared with the local benefits.[83]

In future analysis, the Court must now consider the implications of whether the law favors local government. As the distinction was razor-thin between *Carbone* and *United Haulers*, so too will the distinction be thin in future cases.[84] The question no longer is whether the law discriminates against interstate commerce, but whether favorability to local government provides an exception to the Dormant Commerce Clause prohibition. In this manner, how does a public law favoring a private nonprofit organization providing wireless technology services exclusively to a town, compare to a state agency fulfilling the same objectives? Under the distinction drawn in *United Haulers*, they appear to receive different treatment—the state agency would be

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[75] *Id.* at 1795.

[76] *Id.* at 1797. For an explanation of what constitutes the *Pike* test, see *infra* notes 90–96 and accompanying text.

[77] *Id.* at 1793 (citing City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978)).

[78] Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801, 1817 (2008).

[79] *United Haulers*, 127 S. Ct. at 1795 (plurality opinion).

[80] *Id.* at 1791 n.2.

[81] *Id.* at 1797.

[82] *City of Philadelphia*, 437 U.S. at 624.

[83] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

[84] For a discussion of *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383 (1994), see *infra* notes 133–35, 171–74 and accompanying text.

exempted while the nonprofit organization would be prohibited. The services are substantially the same, so it seems the only plausible explanation for the distinction is the strength of the State's interest in favoring local government.

B. Economic Protectionism

When addressing the validity of statutes under the Commerce Clause, the Court answers a broad question, the public or private dichotomy aside, before determining the level of scrutiny with which to assess the statute. The Court must consider whether the statute is inherently protectionist.[85] In the case of an economically protectionist statute, the scrutiny is much more stringent and severe than when the statute addresses local concerns with incidental effects on interstate commerce.[86] The Court's jurisprudence consistently holds discriminatory laws motivated primarily by economic protectionism to be contrary to the Dormant Commerce Clause by a "virtually *per se* rule of invalidity."[87] This presumption of invalidity can be rebutted by fulfilling the Court's haphazard attempt at heightened scrutiny analysis.[88] In *City of Philadelphia v. New Jersey*, the Court found that a statute prohibiting importation of solid waste originating outside of New Jersey to be economically protectionist and contrary to the Commerce Clause.[89] In nearly all discernible cases, the Court has found economic protectionism to be dispositive.

When a statute is not economically protectionist on its face, in its purpose, or in its effect, the Court applies the *Pike* test to determine whether the law was directed toward legitimate local concerns and whether the burden imposed on interstate commerce is clearly excessive in relation to the local benefits.[90] In *Pike v. Bruce Church, Inc.*, Arizona required uniform packaging containers for all fruits and vegetables shipped within the state, primarily in response to consumer dissatisfaction and Arizona growers' declining reputations as some shipped inferior produce.[91] To comply, Bruce Church Inc. would have needed to build a new packaging plant at a cost of $200,000, which would have prevented their participation in Arizona's produce markets.[92] The statute appeared facially neutral, yet required a company to operate in Arizona to package produce properly.[93] Despite the potentially discriminatory effect, the Court decided it was appropriate to require a balancing of the State's interests against the burden on interstate commerce.[94] Similar to much of the Court's Fourteenth Amendment

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[85] *City of Philadelphia*, 437 U.S. at 624.

[86] *Id.*

[87] *Id.; see, e.g.*, Toomer v. Witsell, 334 U.S. 385, 403–06 (1948).

[88] *See, e.g., City of Philadelphia*, 437 U.S. at 626–28.

[89] *Id.* at 628.

[90] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

[91] *Id.*

[92] *Id.* at 144.

[93] *Id.* at 145.

[94] *Id.* at 145–46.

jurisprudence, the *Pike* test involves a balancing of policies, benefits, and burdens.[95] As a result, it employs less searching scrutiny and merely requires that the burden is less than excessive as compared to the purported local benefits.[96]

This economic protectionism standard becomes murky when considering close cases. In *Hunt v. Washington State Apple Advertising Commission*, a North Carolina statute required uniform labeling across all shipping crates of apples, regardless of their point of origin.[97] The Court found the statute to be facially neutral and not economically protectionist on its face, yet stated that it was discriminatory in effect because it imposed a significant burden on Washington apple growers.[98] The Court required the State to prove the substance of the local benefits and that there were no non-discriminatory alternatives that would preserve those local benefits equally well.[99] Under traditional Dormant Commerce Clause doctrine, it would have been discriminatory in effect and would have been presumed economically protectionist, subjecting the statute to higher scrutiny. In this case, the Court's test sounded eerily similar to the balancing test employed in *Pike*.[100] The Court failed to adequately draw the distinction and would likely have come to a different result under *Pike*.

In *Dean Milk Co. v. City of Madison*, the Court declared unconstitutional an ordinance requiring milk sold in Madison to be pasteurized within five miles of the city.[101] The ordinance did not facially discriminate against out-of-state milk, but required it be pasteurized in the area in the wake of local health concerns.[102] The Court found that the law was discriminatory in effect and unconstitutional because there were less burdensome alternatives.[103] This case, like *Hunt*, is eerily similar to *Pike* in its effect and discrimination against interstate commerce, yet the two cases are

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[95] The Court in *Davis* seemed to rebuke the *Pike* test, suggesting "that the Judicial Branch is not institutionally suited to draw reliable conclusions of the kind that would be necessary for the Davises to satisfy a *Pike* burden in this particular case." Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801, 1817 (2008). In that statement, the Court suggests the *Pike* test is inappropriate, but only for this case, while still leaving the possibility open for its reversal in the future. At this point, *Pike* remains good law. Justice Scalia, on the other hand, stated that he "would abandon the *Pike*-balancing enterprise altogether and leave these quintessentially legislative judgments with the branch to which the Constitution assigns them." *Id.* at 1821 (Scalia, J., concurring in part).

[96] *Pike*, 397 U.S. at 142; *see, e.g.*, Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 471 (1981) (citing *Pike* as requiring the Court to strike even-handed statutes imposing incidental burdens on interstate commerce if the burden is clearly excessive in relation to the putative local benefits).

[97] 432 U.S. 333, 336 (1977).

[98] *Id.* at 352–53.

[99] *Id.* at 353.

[100] *Id.*

[101] 340 U.S. 349 (1951).

[102] *Id.* at 352–53.

[103] *Id.* at 354.

treated much differently and perhaps decided incorrectly as a result of the determination as to their discriminatory or economically protectionist effect. This distinction only furthers the gross categorization difficulties of the Dormant Commerce Clause, indicating a need for a standard that accounts for these differences without requiring square pegs to fit in round holes.

C. Market Participant Exception

As the Supreme Court expanded Dormant Commerce Clause doctrine, it necessarily collided with the needs and practicality of the State in participating in the marketplace. States readily act as buyers and sellers in a continually expanding national and international market, which pushes the State beyond its traditional role as solely a governmental entity. Sensing this paradigm shift,[104] the Court developed the market participant doctrine, primarily through its decision in *Hughes v. Alexandria Scrap Corp.*[105]

What initially began as consideration of an aesthetic problem of abandoned automobiles became essentially an incentivized clean-up program.[106] Maryland's legislature sought to eliminate old automobile hulks, defined as inoperable automobiles over eight years old, lining junkyards, blighted areas, and roadsides.[107] The State rewarded those recyclers with a "bounty" for each hulk retrieved and delivered to a licensed scrap metal processor.[108] In 1974, Maryland supplemented the provisions by requiring documents proving clear title before receiving the bounty.[109] In-state processors were only required to submit a statement from the deliverer, whereas the law required out-of-state processors to submit a certificate of title.[110] As a result, Alexandria Scrap challenged the law, stating it violated the Commerce Clause by impeding interstate commerce.[111]

In its decision, the Court contrasted Maryland's actions with those of other governmental entities who had undertaken interstate market regulations.[112] According

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[104] *See generally* THOMAS S. KUHN, THE STRUCTURE OF SCIENTIFIC REVOLUTIONS (1996) (defining paradigm shifts as academic and intellectual revolutions in the midst of peaceful developments, such that there are changes in fundamental assumptions or bedrock doctrine).

[105] 426 U.S. 794 (1976).

[106] *Id.* at 796.

[107] *Id.* at 796–97.

[108] *Id.* at 797 (citing MD. ANN. CODE art. 66½, § 5-205 (Supp. 1975)).

[109] *Id.* at 800 (citing 1974 Md. Laws, c. 465).

[110] *Id.* at 800–01. The law only required Maryland processors to submit a signed statement from the deliverer claiming his right to the automobile and to indemnify the processor if title became uncertain. *Id.* Non-Maryland processors, however, were required to submit a certificate of title, which made out-of-state participation much more challenging. *Id.*

[111] *Id.* at 802.

[112] *Id.* at 805–06; *see, e.g.*, H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525 (1949); Toomer v. Witsell, 334 U.S. 385 (1948).

to the Court, the impact in those prior cases was interference with the "natural functioning of the interstate market" through prohibition or regulation.[113] The difference between Maryland and the other state actions was that Maryland "entered into the market itself" as opposed to acting as a market regulator.[114] The Court stated, "[n]othing in the purposes animating the Commerce Clause prohibits a State . . . from participating in the market and exercising the right to favor its own citizens over others."[115] From this holding, which was later expanded in other cases, the Court created the market participant exception.[116]

The Court faced several concerns. First, in cases like *Alexandria Scrap*, the State acts like a buyer or seller in the market, temporarily abandoning its role as a market regulator.[117] Businesses may sell to or buy from any subset of the population they choose. Similarly, when states enter a role akin to a private business, such rights should apply.[118] The Court in *Reeves, Inc. v. Stake* decided, in part, on this argument.[119] South Dakota built a state-owned cement facility to provide an adequate supply to its citizens in times of shortage.[120] During those times, state policy was to prevent sales out-of-state and only sell to its residents, effectively discriminating against out-of-state purchasers.[121] The Court found that state proprietary activity was also subject to the same restrictions as private business, and "[e]venhandedness suggests" states should share the same freedoms, in particular, to buy and sell from those of their choosing.[122] The Court noted the difference between the State as a private entity and participant compared to its role as a regulator was inherent in the Commerce Clause.[123]

The Court has seen this distinction before and has ruled on the dual role of government as both a market regulator and market participant. In *White v. Massachusetts Council of Construction Employees, Inc.*, a local ordinance in Boston required

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[113] *Alexandria Scrap Corp.*, 426 U.S. at 806.

[114] *Id.*

[115] *Id.* at 810.

[116] *See* Reeves, Inc. v. Stake, 447 U.S. 429, 436 (1980) ("The basic distinction drawn in *Alexandria Scrap* between States as market participants and States as market regulators makes good sense and sound law.").

[117] *Alexandria Scrap Corp.*, 426 U.S. at 809.

[118] *Reeves, Inc.*, 447 U.S. at 439 (holding a state-run cement plant in South Dakota was a market participant and when acting as such, states are afforded similar market freedoms); *see also* Perkins v. Lukens Steel Co., 310 U.S. 113, 127 (1940) ("Like private individuals and businesses, the Government enjoys the unrestricted power to produce its own supplies, to determine those with whom it will deal, and to fix the terms and conditions upon which it will make needed purchases.").

[119] *Reeves, Inc.*, 447 U.S. at 436–37.

[120] *Id.* at 430.

[121] *Id.* at 432.

[122] *Id.* at 439.

[123] *Id.* at 436–37 ("As [*Alexandria Scrap Corp.*] explains, the Commerce Clause responds principally to state taxes and regulatory measures impeding free private trade in the national marketplace.").

construction projects paid for partially or fully with city funds had to be performed and completed by work forces with at least half of its crew as residents of Boston.[124] The government acted in dual roles in *White*, acting as a regulator by requiring a certain percentage of the employees be residents of Boston, and as a participant by employing the firms it chose to build its public works projects.[125] The actions in regulation and in participation complemented one another—the participation in selecting its construction firms complemented the regulation requiring Boston residents as at least half of the work force by ensuring that the city's goals and objectives were fulfilled. Similarly, the Court in *Davis* recognized this distinction, noting that issuing bonds was the State and locality acting in its market participant role and that differential taxation was within its role as market regulator.[126] The Court stated that the roles of regulator and participant cannot be viewed in isolation as any type of Commerce Clause economic protectionism or discrimination.[127] In *Davis*, as compared to *White*, the roles of the government were essentially the same—part regulator, part participant—dual, joint, and continuing. In the same manner as in *White*, as the Court in *Davis* noted, it is not unconstitutional discrimination if it creates a commercial advantage for local governments, even if they are acting in dual roles.[128] Acting in these dual roles cannot be seen in isolation, and the State's role as a market participant is only further muddied as it is uncertain how to adequately place the majority of the State's influence—as either favoring private industry or acting in the public's interest.

The market participant exception continually demonstrates its importance as states become players in various industries, including state production of products for consumer and manufacturer use.[129] A serious problem arises when a state acts

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[124] 460 U.S. 204, 206 (1983).

[125] *Id.* at 214–15 ("Insofar as the city expended only its own funds in entering into construction contracts for public projects, it was a market participant . . . . Insofar as the Mayor's executive order was applied to projects funded [by federal programs] the order was affirmatively sanctioned by the pertinent regulations of those programs.").

[126] Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801, 1812 (2008) (plurality opinion) (stating that the Davises made "a fair point to the extent that they argue that Kentucky acts in two roles at once, issuing bonds and setting taxes," then proceeding to analyze the distinctions in roles).

[127] *Id.* "It simply blinks this reality to disaggregate the Commonwealth's two roles and pretend that in exempting the income from its securities, Kentucky is independently regulating or regulating in the garden variety way that has made a State vulnerable to the dormant Commerce Clause." *Id.* Justice Souter also remarked that viewing the regulation and participation in isolation was "a denial of economic reality." *Id.* at 1814 n.17.

[128] *See id.* at 1812–14. The plurality in *Davis* makes the point that "cases on market participation joined with regulation (the usual situation) prescribe exceptional treatment for this direct governmental activity in commercial markets for the public's benefit." *Id.* at 1814 (footnote omitted). The plurality then stated that Kentucky's taxation scheme is not a violation of the Dormant Commerce Clause "because the Commonwealth's direct participation favors, not local private entrepreneurs, but the Commonwealth and local governments." *Id.* The plurality said it was not unconstitutional within the dual roles. *Id.*

[129] *See, e.g.*, Reeves, Inc. v. Stake, 447 U.S. 429 (1980).

as both a regulator of an industry, through taxes, for example, and as a participant in the market. Where does the Court draw the line between participant and regulator when the State is essentially wearing both hats? If in *Reeves*, South Dakota decided to unfavorably tax all of its cement-producing opponents, it would clearly make South Dakota a market regulator as well, but how, if at all, would that change the analysis in the Court's market participant exception? This muddied consideration leaves little room for the Court to decide without developing a more principled standard for its Dormant Commerce Clause analysis.

D. Looking Back Before Looking Forward

Beyond the implications of the market participant exception, the Court's current Dormant Commerce Clause doctrine is fraught with confusion, uncertainty, and little proper guidance.[130] With the advent of *United Haulers*, the Court required an initial inquiry into whether the law favors local government—another question to answer before finding any substantive discussion of the local law in question.[131] In answering these questions and categorically applying their answers to any set of facts, imprudent results may arise. Consider *C & A Carbone, Inc. v. Town of Clarkstown*, wherein Clarkstown, New York, provided its trash services to a private vendor in exchange for construction of a waste facility that would be turned over to the city after five years.[132] In that case, which the Court discusses in *United Haulers*,[133] the law clearly favored the private vendor by providing trash services, but it also benefited the city by having a city waste facility five years later and free of debt obligations.[134] The Court in *United Haulers* distinguished the cases, but can it be said that categorization based on favoring local government is proper? This Note appreciates the distinction—and many others created by a patchwork of decisions—but believes a more balanced approach can provide the Court with structured footing for its analysis.

IV. PROPOSING A NEW STANDARD

A. A New Standard

This Note proposes a significant shift in Dormant Commerce Clause doctrine by adjusting the standard used by the Supreme Court in deciding whether state laws

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[130] Winkfield F. Twyman, Jr., *Beyond Purpose: Addressing State Discrimination in Interstate Commerce*, 46 S.C. L. REV. 381, 383 (1995) (describing current Dormant Commerce Clause doctrine as incoherent, unclear, and full of "myriad shadows").

[131] United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 127 S. Ct. 1786, 1795–96 (2007) (plurality opinion).

[132] 511 U.S. 383 (1994).

[133] 127 S. Ct. at 1793–95 (plurality opinion).

[134] *Carbone*, 511 U.S. at 387.

promulgated violate the negative aspect of the Commerce Clause. This Note proposes that the Supreme Court use a variation on the strict scrutiny standard to examine the state law, its purpose and justification, and the strength of the State's interest in legislating the issue. Strict scrutiny, in its analogous use with the Dormant Commerce Clause, proves to be a more "principled" approach,[135] imposes less judicial public policy considerations without prior legislative action, and encourages free markets across states rather than "Balkanization"[136] when the State's interest is not compelling.

In discrimination and suspect class cases under the Fourteenth Amendment, the Supreme Court frequently uses strict scrutiny to analyze the constitutionality of those dubious laws.[137] Under a similar variation, this Note proposes the Supreme Court require a compelling state interest justifying restrictions on interstate commerce. Furthermore, the State should narrowly tailor the law to impose the least burdensome alternative required to fulfill the compelling interest. The Court infrequently used a standard vaguely akin to that proposed here, though less rigorous and closer to an intermediate scrutiny standard to assess potential Dormant Commerce Clause violations.[138] This Note proposes the Court use a strict scrutiny standard when considering local laws that are facially discriminatory or facially neutral in their treatment of interstate commerce.

B. Development of Strict Scrutiny

The origins of strict scrutiny are relatively unknown, or at the least unclear, though many attribute it to Justice Stone's opinion for the majority, in particular footnote four, in *United States v. Carolene Products Co.*[139] The doctrine would strike down statutes drawn for discriminatory purposes and other suspect uses, while allowing statutes protecting "vital government interests" to "survive."[140] Its modern interpretation developed as a doctrine in response to many delicate issues clouding the Court during the Warren era.[141] The Court faced racial discrimination,[142] privacy

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[135] *United Haulers*, 127 S. Ct. at 1801 (Thomas, J., concurring).

[136] *See, e.g.*, Or. Waste Sys., Inc. v. Dep't of Envtl. Quality, 511 U.S. 93, 98 (1994) (discussing the interest in "avoid[ing] the tendencies toward economic Balkanization").

[137] *See, e.g.*, Regents of the Univ. of Cal. v. Bakke, 438 U.S. 265 (1978) (holding that racial classifications are still subject to strict scrutiny even if they are benign classifications).

[138] *See, e.g.*, New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278–79 (1988) (stating that precedent allows local statutes and ordinances to be upheld if there is a "legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives").

[139] 304 U.S. 144, 152 n.4 (1938) (stating it was unnecessary to determine whether discriminatory legislation was "to be subjected to more exacting judicial scrutiny under the general prohibitions of the Fourteenth Amendment than are most other types of legislation"); *see also* Richard H. Fallon, Jr., *Strict Judicial Scrutiny*, 54 UCLA L. REV. 1267, 1270 (2007).

[140] Fallon, *supra* note 139, at 1271.

[141] *Id.* at 1270.

[142] *See* Brown v. Bd. of Educ., 347 U.S. 483 (1954); Korematsu v. United States, 323 U.S.

intrusions,[143] and freedom of speech restrictions,[144] which redefined how the Court approached issues of fundamental rights of citizens.

The Court searched for a method that would avoid the problems associated with previous balancing criticisms and recalcitrant second-guessing of congressional and state legislation.[145] In the early 1900s, the Court decided *Lochner v. New York*, which held a labor law restricting the hours a baker could work, for the purpose of protecting the baker's health, to be unconstitutional.[146] This decision led to a series of cases during the Progressive Era and the Great Depression that struck down economic regulations deemed to violate individuals' rights.[147] During that time, there was little in the way of a coherent standard the Court used to structure its opinions.[148] After 1937, the Court slowly began to develop its standards of review, in particular, to create strict scrutiny to adjudicate cases with various types of discrimination.[149]

The strict scrutiny standard became a "generic test for the protection of fundamental rights" as the Court faced more complicated personal liberty issues.[150] It "impose[d] discipline . . . on judicial decisionmaking" and provided a solution to protect fundamental rights that were inadequately protected under rational basis review.[151] Such a standard of review would provide structure to balancing challenges, untenable and untethered judicial action, and policy-driven decisions that have plagued the Court's Dormant Commerce Clause doctrine for nearly a century, much in the way that it provided a framework for a wandering Court after the *Lochner* era.

214, 216 (1944) (stating that racial classifications required "the most rigid scrutiny").

[143] *See* Griswold v. Connecticut, 381 U.S. 479 (1965) (holding that a law prohibiting use of contraception violated spousal privacy).

[144] *See generally* Brandenburg v. Ohio, 395 U.S. 444 (1969) (holding the Ohio Criminal Syndicalism Act to be unconstitutional for violating the First Amendment's guarantee of free speech).

[145] *See, e.g.*, Hammer v. Dagenhart, 247 U.S. 251 (1918); Lochner v. New York, 198 U.S. 45 (1905).

[146] 198 U.S. 45 (1905). *Lochner* was later overturned, or at least its principles and methodology discarded, in a series of cases leading up to the Court's decision in *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937) (holding that a minimum wage statute enacted by Washington state was constitutional). The *Lochner* era, as it came to be known, was marred by decisions that seemed to be made more by personal ideology than by objective, constitutional principles. The *Lochner* era saw the Court neglect to use any tenable or consistent standard for reviewing cases with any discriminatory implications. Fallon, *supra* note 139.

[147] *See, e.g.*, *Hammer*, 247 U.S. 251 (holding the Tenth Amendment to be a restriction on Congress's authority to regulate commerce).

[148] Fallon, *supra* note 139.

[149] *See supra* notes 140–45 and accompanying text.

[150] Fallon, *supra* note 139, at 1271.

[151] *Id.* at 1270.

C. Reasons for Strict Scrutiny in Dormant Commerce Clause Cases

1. A More Principled Approach

Strict scrutiny, as opposed to other approaches under the Dormant Commerce Clause, provides a more "principled" approach,[152] which the Court typically desires, especially where doctrine has been continuously murky for nearly a century.[153] It allows the Court to follow a structured process in deciding cases on a uniform basis, while still allowing flexibility to adjust to the facts of specific cases. Requiring a compelling government interest when there is economic protectionism sets an objective standard for courts to apply and for legislatures to achieve.

The Court essentially uses something akin to strict scrutiny in Dormant Commerce Clause cases, but never truly follows the formal analysis to any consistent, principled approach.[154] More accurately, the Court uses an intermediate scrutiny standard, of sorts, as its basis for review in Dormant Commerce Clause cases.[155] Such a standard bows more to the "judicial whims" of the ideological focus of each Justice as opposed to the constitutional analysis that it requires. Less exacting standards for the strength of the State's interest allow public policy implications to become more significant in allowing an otherwise protectionist law to stand. Those less exacting standards create great uncertainty in the use and understanding of the several distinctions the Court makes before deciding a Dormant Commerce Clause case. The varying categorical tests not only create uncertainty, but also provide little guidance for district courts and circuit courts in following Court precedent. Providing the formalized, and stricter, structure allows the Court to make decisions harmonious to precedent, while adding a stronger basis for predictability in future decisions.[156]

2. Properly Explains Precedent in a Principled, Predictable Context

Applying strict scrutiny properly explains most Dormant Commerce Clause precedent, yet does so in a principled and predictable context. The considerations and

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[152] United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 127 S. Ct. 1786, 1801 (2007) (Thomas, J., concurring).

[153] *Id.*

[154] *Id.* at 1806–09 (Alito, J., dissenting).

[155] *Id.* at 1795–96.

[156] *See, e.g.*, Peter Caldwell, *Hostile Environment Sexual Harassment & First Amendment Content-Neutrality: Putting the Supreme Court on the Right Path*, 23 HOFSTRA LAB. & EMP. L.J. 373, 407 (2006) (recommending strict scrutiny as a way for the Supreme Court to solve the difficulties of content-neutrality analysis); Elizabeth Blanks Hindman, *The Chickens Have Come Home to Roost: Individualism, Collectivism and Conflict in Commercial Speech Doctrine*, 9 COMM. L. & POL'Y 237 (2004) (recommending strict scrutiny as a principled approach to deciding commercial speech cases).

distinctions made by the Court in earlier cases still have bearing on decisions under strict scrutiny, but are not dispositive and are not prohibitive. *United Haulers*, for instance, would still have been decided in favor of the county due to the strength of the county's interest in providing waste management services. The county's interest was strong and the law was evenly applied to in-state and out-of-state business. Furthermore, the State's interest in *Maine v. Taylor* would not only be compelling, but restricting the importation of fish that would have carried the parasite is a prime example of narrowly tailored legislation to fit that compelling interest.[157] Beyond satisfying precedent in a controlled manner, the strict scrutiny doctrine accounts for the market participant exception, which the Court touted in *Alexandria Scrap* and *Reeves*.[158] In cases blurring the lines of any clear-cut distinctions, such as quasi-public entities or facially neutral laws with negligible impact on interstate commerce, strict scrutiny properly decides those cases based on varying considerations. In a way unlike any of the Court's attempts, strict scrutiny in the Dormant Commerce Clause context provides a principled and predictable approach that explains past precedent under its terms.

3. Predictability and Stability for State and Local Legislatures

Beyond its principled application in cases before the Court, strict scrutiny would provide a more structured basis upon which states could enact laws regarding interstate commerce. Strict scrutiny would enable state legislatures considering future legislation to account accurately for the constitutional implications of restricting out-of-state commerce or preferring local business. For example, in creating a state statute regarding milk regulation, a legislature inevitably encounters challenges under the Dormant Commerce Clause, but the question remains as to how courts will react to the implementation and application of the statute. The current patchwork standard creates uncertainty and challenges for states and localities, but using strict scrutiny quells those uncertainties and challenges. How is a state to determine under which categorical determination its law falls? A state developing uniform waste management laws and attempting to reduce its landfill use by eliminating out-of-state trash deposits faces the economic discrimination distinction and classification, but under strict scrutiny, public health is a factor in the State's interest and the scope of the law discerns whether it is narrowly tailored. A city creating a wastewater treatment facility for temporarily private benefit and soon to be turned over to the town, under current doctrine, is subject to the public/private distinction, yet under strict scrutiny it factors into the strength of the State's interest. Under current doctrine, the cases are fraught

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[157] For a discussion of *Maine v. Taylor*, 477 U.S. 131 (1986), see *infra* notes 180–85 and accompanying text.

[158] *See* Reeves, Inc. v. Stake, 447 U.S. 429 (1980); Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976).

with confusion and do not provide predictability or guidance to lower courts, state legislatures, or city councils. Using a strict scrutiny analysis, the Court would be able to provide more stable and predictable decisions to guide local lawmakers in creating laws that avoid Dormant Commerce Clause implications.

4. Expanding Free Markets

A strict scrutiny regime encourages the expansion of the ideals behind the Dormant Commerce Clause—in particular, expanding free trade within the states and reducing market segmentation. The Court in *Hughes v. Oklahoma* noted that the Framers designed the Commerce Clause to "avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation."[159] The Framers also intended to prevent states from economically retaliating against one another by enacting similar statutes to prohibit out-of-state business from participating in in-state commerce.[160] The overall effect and encouragement of Dormant Commerce Clause doctrine is to encourage the development of a free and national market, unburdened of restraints between states in interstate commerce.[161] Adjusting the standard to strict scrutiny encourages free trade with only limited state interference by requiring those statutes burdening interstate commerce to be supported by compelling state justifications and narrowly tailored to fit those interests.

If strict scrutiny was the standard, it would discourage laws that protect local business because the State's interest in protecting local business would not typically rise to "compelling." Moreover, there would likely be less burdensome alternatives. If Virginia decided to implement a law requiring all stores selling North Carolina tobacco products to sell Virginia tobacco products and at a lower price, the law would fail strict scrutiny analysis. The State's interest in promoting local tobacco producers and increasing tobacco sales would have little to do with benefitting public health or welfare. The lower price would also interfere with North Carolina's tobacco industry based on state borders alone, reducing interstate commerce. Even if there were a compelling justification, there would be several less burdensome alternatives that would allow the Virginia tobacco industry to expand, including increased subsidies, state advertising campaigns, state purchases of tobacco, and other considerations. The Court would strike down that statute as violating the Dormant Commerce Clause and would allow for products from North Carolina to flow into Virginia, encouraging increased trade.

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[159] Hughes v. Oklahoma, 441 U.S. 322, 325–26 (1979).

[160] C & A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383, 390 (1994) (stating that discriminatory statutes "excite those jealousies and retaliatory measures the Constitution was designed to prevent").

[161] *See* Comment, *The Uniformity Clause*, 51 U. CHI. L. REV. 1193, 1213–15 (1984) (discussing the economic and free trade implications of the Dormant Commerce Clause and suggesting it encourages national uniformity in commerce).

D. Analyzing Past Precedent Under Strict Scrutiny

The imposition of strict scrutiny in a course of constitutional law embedded in more than a century's worth of decisions poses difficult questions as to those decisions' applicability to cases going forward. By considering each of the cases under different elements of the standard of review, we can discern how, if at all, such defined and settled cases would pertain to new doctrinal standards. In this section, this Note considers each of the main elements of strict scrutiny—compelling State justification and interest, narrowly tailored, and no less burdensome alternatives—to determine how several past cases fit into the new standard and may relate to future Dormant Commerce Clause applications, then applies those elements to one of the foremost Dormant Commerce Clause cases.

1. Past Cases Concerning Compelling State Justification and Interest

In cases where strict scrutiny is applied, the Court requires the State to have a compelling interest or justification for legislating the issue as it did.[162] By requiring a compelling interest, the Court stringently protects those rights that it deems to be fundamental or essential. In the context of the Dormant Commerce Clause, it safeguards the operation of a national market and promotes economic efficiency through free trade. Those interests tend to be strong, but still may be overridden by local ordinances or state legislation to protect its own local economic interests.

In *United Haulers*, the Court enunciated the public/private distinction wherein public facilities and entities may be favored in interstate commerce.[163] This distinction, as Justice Alito states—and with which Justices Stevens and Kennedy agree—is one that is both "illusory and without precedent."[164] Under a strict scrutiny regime, this distinction is no longer dispositive, but rather provides the State with a stronger compelling interest in the analysis. Local government has significant responsibilities in ensuring the welfare, health, and safety of its citizens, which "set state and local government apart from a typical private business."[165] Laws protecting local government "may be directed toward any number of legitimate goals unrelated to protectionism."[166]

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[162] *See, e.g.*, Grutter v. Bollinger, 539 U.S. 306 (2003) (holding student body diversity was a compelling State interest that justified the use of race in law school admissions); Roe v. Wade, 410 U.S. 113 (1973) (holding the end of the first trimester to be an approximate point at which the State's interest became compelling to protect the health of the mother and the viability of the child).

[163] United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 127 S. Ct. 1786, 1793–95 (2007). The Court also noted other distinctions with *Carbone*, which allowed the local law in *United Haulers* to survive Dormant Commerce Clause doctrine, but the primary distinction came over the nature of the facility favored. *Id.*

[164] *Id.* at 1804 (Alito, J., dissenting).

[165] *Id.* at 1795 (majority opinion).

[166] *Id.* at 1796.

As a result, the State's interest in legislating for the public's welfare benefit is more compelling than legislating for private economic benefit. Furthermore, a democratic vote by the citizens of the counties provides additional strength to the government's interest, in that it was understood, desired, and approved by its citizens.[167] By favoring and supporting a public entity for the welfare of the State, the compelling nature of the interest is achieved and reaffirmed, fulfilling the first prong of strict scrutiny review.

United Haulers may survive strict scrutiny, but the standard allows public favoritism without a sufficient governmental interest to be declared unconstitutional. The Court—Justice Thomas, for one—is apprehensive about expanding discrimination in favor of state-owned or local municipality operations on grounds that it protects and benefits local private interests and is simple economic protectionism, despite arguments that it solely benefits local municipalities.[168] The concern appears to be over a slippery slope into a socialist mindset for states and localities, suggesting that a bright-line rule that discrimination benefitting public entities and excluding private participants encourages excessive government intervention into free markets.[169] In using a strict scrutiny standard, discrimination benefitting a public entity without a compelling justification and not narrowly tailored would be unconstitutional and prevent a slide down the slippery slope.

Compared to *United Haulers*, *Carbone* suggested that legislation benefitting private facilities provides a weaker State justification and does not fulfill the requirement for a compelling State interest.[170] In *Carbone*, Clarkstown, New York, encouraged a local private contractor to build and operate for five years a local solid waste transfer station, at a cost of $1.4 million, before conveying it to the town for nominal consideration.[171] The deal would have guaranteed tipping fees to the private contractor by ordinance requiring all solid waste within the town to be deposited at that transfer station.[172] As a result, the ordinance only benefitted the private contractor by essentially providing a private monopoly on local garbage processing. The Court struck down the ordinance, saying it was clear economic protectionism and prevented out-of-state competitors from pedaling their products within the local municipality.[173] In the context of strict scrutiny analysis, the State's interest in protecting private industry is significantly lower than the State's interest in protecting and promoting its

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[167] *Id.* at 1797.

[168] *Id.* at 1801 (Thomas, J., concurring).

[169] *Id.*

[170] *See* C & A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383 (1994) (holding that a local ordinance requiring solid waste be processed within the town be handled at the town's transfer station was unconstitutional on grounds it discriminated against interstate commerce in part for favoring a private business and precluding competition).

[171] *Id.* at 387.

[172] *Id.*

[173] *Id.* at 390.

citizens' health, welfare, and safety. Had the State in *Carbone* had a primary purpose of promoting any of those justifications, the public's interest may have been stronger; however, supporting a private industry indicates a lower State interest or justification in establishing the local ordinance. The argument can be made that it was in the State's strongest interests to encourage the local contractor, mainly because the State would essentially have a waste transfer station built at another's expense; however, the private short-run benefits accrued to the private contractor, and costs paid by all residents of the town weighed down the State's interest. As the Court stated it was unconstitutional in *Carbone*, so too would the ordinance be unconstitutional under a strict scrutiny regime.

Considering *Hunt v. Washington State Apple Advertising Commission* provides further insight into the compelling justification requirement.[174] In restricting the packaging and labeling used on apple crates shipped to the state, North Carolina attempted to "eliminate this source of deception and confusion by replacing the numerous state grades with a single uniform standard."[175] The Court saw through these dubious claims and recognized the statute as supporting local North Carolina apple growers by raising the cost of business for out-of-state farmers.[176] In a case like this, concerns of narrow tailoring and less burdensome alternatives aside, the State's interest is exceptionally weak. Reducing consumer confusion between various state grades of apples has little to do with public welfare, health, or safety, and is not significant enough to justify a massive cost increase across the board for out-of-state apple growers.[177] Under strict scrutiny, the Court would be hard-pressed to find a compelling justification for State interference, thus striking the statute down and falling in line with the Court's decision.

2. Past Cases Concerning Narrowly Tailored Legislation

Strict scrutiny also requires that laws be narrowly tailored to fit their proclaimed purpose and the State's interest in legislating the issue.[178] This ensures that states and localities are legislating within the limits of their interest in infringing on a fundamental right; moreover, it ensures that only those situations that the State intends to influence are actually affected, preventing over- and under-inclusion. This requirement further fulfills the purposes and goals of strict scrutiny, including encouraging predictability in application and future enactment.

In *Maine v. Taylor*, the State enacted a statute prohibiting importation of bait fish to prevent a pandemic across its inland water population.[179] In its argument, the State

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[174] 432 U.S. 333 (1977).

[175] *Id.* at 349.

[176] *Id.* at 350–51.

[177] *Id.* at 351.

[178] *See supra* Part IV.B.

[179] ME. REV. STAT. ANN. tit. 12, § 12556 (2005).

declared it had promoted the statute as a way of ensuring the health of its fishing population as well as preventing the spread of a parasite from relatively remote sections of the state to the vast majority of freshwater stores.[180] The State argued that imported bait fish posed significant threats to Maine's fisheries, namely that indigenous fish would be at risk to contract parasites and nonnative species would disturb the local ecology in unpredictable and subtle ways.[181] The State's experts at trial further argued that they could not inspect shipments of bait fish to determine whether the parasites or commingled species were present.[182] The Court took these compelling justifications and interests into account when assessing the statute's fit.[183] The Court noted that the statute was only legislating against bait fish, which appeared to be the only class of fish both affected by the parasite and unable to be inspected properly.[184] Under the strict scrutiny standard proposed by this Note, the statute is sufficiently narrow as to only include the affected class and is neither over- nor under-inclusive. It does not include trout, salmon, and other game fish, but only those fish affected by the parasite and without a viable inspection procedure. Upheld by the Court under its current patchwork doctrine, it would be similarly upheld under strict scrutiny as being narrowly tailored to fit the State's interest.

A second important example is *Dean Milk Co. v. City of Madison*.[185] A milk company that purchased milk from 950 farms across southern Wisconsin and northern Illinois, producing Grade A milk as rated by public health authorities in Chicago, was denied access to the Madison milk market by an ordinance which required all milk sold in the city to be pasteurized within five miles of the city square.[186] Even if the Court had assumed, under strict scrutiny, that the State's interest in public health and milk quality was compelling, despite claims and arguments suggesting it was for private benefit, the Court would have had trouble upholding the ordinance on grounds the city did not narrowly tailor it to those interests. In this case, banning all milk outside a certain arbitrary mileage is overly broad—it does not allow properly evaluated and inspected milk to be competitive in the market, thus burdening interstate commerce.[187] What makes milk pasteurized two miles away any different from milk pasteurized six miles away? If the city aimed the ordinance at ensuring higher inspection standards, it may find that pasteurized milk within five miles is, in fact, less healthy than milk produced by Dean Milk Company. In order to fulfill the narrowly tailored

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[180] Maine v. Taylor, 477 U.S. 131, 141 (1986).

[181] *Id.*

[182] *Id.* at 141–42.

[183] *Id.* at 143–44.

[184] *Id.* at 141–42 (stating that inspection for parasites required "destruction of the fish" and made it exceptionally challenging to inspect for parasites among bait fish, despite the fact that sampling tests had been created for salmon and trout mixed breeds).

[185] 340 U.S. 349 (1951).

[186] *Id.* at 352.

[187] *Id.* at 350 n.1 (citing General Ordinances of the City of Madison, 1949, § 7.21).

requirement, the city could have enacted an ordinance that required inspection for all milk not obtaining a Grade A rating from approved inspection agencies, such as the Chicago public health authorities. It would have ensured milk quality and not unduly burdened interstate commerce. The requirement for a narrowly tailored law is more protection against interference with interstate commerce, yet it still provides an exception for state and local interests to be met.

3. Past Cases Concerning Less Burdensome Alternatives

Under traditional Dormant Commerce Clause doctrine and under other strict scrutiny regimes throughout constitutional law, courts have required no less restrictive or burdensome alternatives be available before deeming a statute or ordinance constitutional.[188] There must not be a non-discriminatory way of achieving the same result, which is akin to the Court's requirement that the ordinance be narrowly tailored.[189] This ensures there is no needless discrimination against individuals, races, religions, and other classifications. In the context of the Dormant Commerce Clause, it would ensure no needless discrimination against out-of-state entities. Furthermore, the Dormant Commerce Clause doctrine is designed to encourage interstate commerce and reduce barriers preventing trade between states. By ensuring the least burdensome alternative is applied if there is regulation or restriction, it still fulfills those goals and minimizes the effect on a national market.

Similar to considerations of narrowly tailoring the statute, *Maine v. Taylor* also stands for the notion that there were no viable alternatives and the legislation imposed was the least restrictive alternative available. The Court suggested repeatedly that it was near impossible to police the spread of the bait fish parasite without imposing a bar on all out-of-state bait fish from the local fisheries.[190] As a result, the Court saw no viable, less burdensome alternatives available to the State to prevent the proliferation of the parasite and its effect on the local ecology.[191] The Court found the local purposes "could not adequately be served by available nondiscriminatory alternatives" and so upheld the statute as constitutional within the Dormant Commerce Clause.[192] Analyzing *Maine v. Taylor* under the proposed strict scrutiny regime would similarly require there be no viable and less burdensome or less discriminatory alternatives. Due to the fact there was no inspection method satisfactory to determine whether the

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[188] *Roe* and *Grutter* both provide an overview of the application and implementation of the strict scrutiny standard, including the tacit requirement for the restriction on a fundamental right to be the least burdensome alternative. *See supra* note 162 and accompanying text.

[189] *See supra* notes 178–87 and accompanying text.

[190] *See* Maine v. Taylor, 477 U.S. 131, 141–42 (1986) (recalling lower court expert testimony indicating that sampling the shipments and the inspection procedures would cause bait fish to die prior to concluding the tests).

[191] *Id.* at 151.

[192] *Id.*

parasite existed and to allow the fish to survive inspection and importation, there would be no less restrictive alternatives.

4. A Broader Look at *City of Philadelphia v. New Jersey*

In *City of Philadelphia v. New Jersey*, the Court held a New Jersey statute prohibiting importation of waste originated or collected outside the state to be unconstitutional.[193] New Jersey enacted a statute preventing outside trash from crossing state lines into New Jersey, purported to be a health measure to diminish the spread of viruses, diseases, and reduce outside health risks.[194] Protection of the health, safety, and welfare of a state's citizens suggests a strong, if not compelling, interest and justification in infringing upon interstate commerce in an attempt to alleviate the other pressing concerns. The Court noted that there were valid justifications for the law, but that it had several other issues that would make it unconstitutional.[195]

First, the Court said the statute was overly broad and drew boundaries around the state in an attempt to protect the economic welfare of local business.[196] Trash in New Jersey is no different from trash in any other state, so to exclude trash from importation merely on grounds that it was from another state essentially creates state border barriers.[197] The Court's argument suggests that since the origin was indistinguishable, it was overly broad by preventing trash from any other state without a true justification for imposing such a restraint.[198] The State's interest in reducing landfill levels as a means of improving health and welfare stretched beyond its authority in developing the state-boundary scope of the statute. Under strict scrutiny, the Court would require—which seems to have applied in *City of Philadelphia*—the State to narrowly tailor the statute to fit the State's interest and compelling justification. In this case, the State did not narrowly tailor the statute to affect the State's interest and so the statute should be overturned on those grounds.

Second, there were several alternatives open to New Jersey in order to protect health, safety, and welfare. Instilling a large-scale prohibition on trash from any other

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[193] 437 U.S. 617 (1978).

[194] *Id.* at 625 (reciting that the purpose of the statute was for the public health, safety, and welfare of the citizens of New Jersey).

[195] One concern not addressed here is that the Court found the law not to be equivalent to a quarantine law. *Id.* at 628–29. For a historical overview of quarantine law and its applications circa 1892 as well as comparisons with current terrorism concerns, see Felice Batlan, *Law in the Time of Cholera: Disease, State Power, and Quarantines Past and Future*, 80 TEMP. L. REV. 53 (2007).

[196] *City of Philadelphia*, 437 U.S. at 628 ("What is crucial is the attempt by one State to isolate itself from a problem common to many by erecting a barrier against the movement of interstate trade.").

[197] *Id.* at 629 ("The harms caused by waste are said to arise after its disposal in landfill sites, and at that point . . . there is no basis to distinguish out-of-state waste from domestic waste.").

[198] *Id.* at 627–28.

place of origin was not the least burdensome alternative the State could have considered in enacting such a statute. Other, less restrictive and burdensome alternatives include capping the amount of land used for landfill purposes, taxing all in-state and out-of-state garbage services to create incentive for individuals to reduce their trash burden, or subsidizing individuals or trash services companies who dump trash in other states. Each of these facially non-discriminatory alternatives provides methods to reduce waste storage in local landfills and presumably improve local health, safety, and welfare. Compared with the language included in the statute, these alternatives would be less burdensome and non-discriminatory, which only reinforces the notion that the statute at issue in *City of Philadelphia* was unconstitutional. Had New Jersey any reason to believe failing health was a result of garbage and waste from a certain region, it would likely have no less burdensome alternative than to restrict trash importation, similar to the restriction on bait fish which the Court approved in *Maine v. Taylor*.

Under a strict scrutiny regime on all economically protectionist statutes questioned by the Dormant Commerce Clause, the statute in *City of Philadelphia* does not fulfill the prongs of the test. First, the State's interest in protecting the health, safety, and welfare of its citizens is generally strong, so the compelling nature of the interest can generally be unquestioned. Second, the statute was overly broad because the legislature did not narrowly tailor it to avoid excluding importation of trash based on state boundaries while still supporting the State's interest in improving local health. Finally, there were several alternatives available to the State that would have been much less intrusive and burdensome on interstate commerce than the method selected. The State could have imposed even-handed taxes to reduce trash influx, subsidized trash exportation, or capped the land available for landfills in an effort to reduce trash levels in the state. Any of these alternatives would have been a much tighter fit to the State's interest and in effecting a law narrowly tailored to affect that interest. Imposing strict scrutiny under the facts of *City of Philadelphia* results in the same decision, yet with a much more disciplined, principled, and structured method of analysis.

5. Market Participant Exception

Under the market participant exception to the Dormant Commerce Clause, states that participate in the market are able to enact legislation ensuring their participation and are able to then discriminate against any while a member of the marketplace. The key examples include Maryland's ability to act as a private entity when purchasing car hulks[199] and South Dakota's actions as a private business selling cement only to residents as an emergency store.[200] As a result, the Court has upheld these statutes and state actions as valid exercises under the Dormant Commerce Clause. Under the

[199] *See* Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976).

[200] *See* Reeves, Inc. v. Stake, 447 U.S. 429 (1980).

strict scrutiny standard, the exception would still exclude state participation in close cases from the purview of the Dormant Commerce Clause, though with a stronger basis for its application.

The Court noted expressly that when States are clearly participants in the market, they are exempted from the limitations of the Dormant Commerce Clause.[201] Clear cases when the State is solely a participant in the market, rather than fulfilling a dual role as a regulator and participant, the Dormant Commerce Clause does not affect State action, though the doctrine is less certain in close cases.[202] When the State has that dual role, much depends on the categorization as a market participant or a market regulator—yet another distinction and categorization that increases doctrinal confusion. By applying strict scrutiny, close cases, which may otherwise rely on this distinction, do not require an explicit categorization, but rather face more contoured analysis. Strict scrutiny would allow states in dual roles to be assessed on the impact and interests inherent in those roles as to whether the Dormant Commerce Clause would restrict action.[203] In *Davis*, Part III-B of the Court's opinion discussed the dual roles of the state government as both a regulator and a participant.[204] The Court, in the only part of the opinion that was a plurality rather than a majority, further blurred the distinction with the market participant doctrine by essentially holding that the dual roles in a taxation context defaults to a participant role.[205] Had the Court applied strict scrutiny, rather than another distinction as to the roles of the State, the dual roles could have been measured, balanced, and tempered to determine the strength of the State's interest and the fit of the statute.

Strict scrutiny, as discussed above, requires a compelling State interest and a law narrowly tailored to fulfill that interest, and the law must be the least burdensome alternative.[206] The market participant exception plays strongly into the State's interest.

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[201] South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 93 (1984) ("Our cases make clear that if a State is acting as a market participant, rather than as a market regulator, the dormant Commerce Clause places no limitation on its activities." (citations omitted)).

[202] From another angle, the market participant exception likely does not reach the point of strict scrutiny analysis because the Dormant Commerce Clause does not prohibit—explicitly or implicitly—the State's participation and the right to favor its citizens expressly in that venture. *Alexandria Scrap Corp.*, 426 U.S. at 810.

[203] For an example of the dual roles, see *White v. Massachusetts Council of Construction Employers, Inc.*, 460 U.S. 204, 206 (1983), and *Department of Revenue of Kentucky v. Davis*, 128 S. Ct. 1801 (2008). Both *White* and *Davis* addressed issues of the dual role of the state government as a participant and regulator, including mention of how it further complicates the Dormant Commerce Clause analysis.

[204] *Davis*, 128 S. Ct. at 1811–14 (plurality opinion); *see also supra* notes 123–28 and accompanying text. Part III-B of the Court's opinion in *Davis* was not joined by Chief Justice Roberts or Justice Ginsburg, which makes that part, and that part alone, a plurality opinion written by Justice Souter. *Id.* at 1804 (majority opinion); *id.* at 1821 (Roberts, C.J., concurring).

[205] *Id.* at 1811–14 (plurality opinion); *see also supra* notes 123–28 and accompanying text.

[206] *See supra* Part IV.A.

As the State steps out of the role of regulator and into the role of participant, it enters the market with a purpose of favoring and benefitting its citizens.[207] The State still competes with others in relevant markets, but merely chooses to deal exclusively with its residents at times, enhancing the State's interest in its actions benefitting local citizens.[208] The strength of the State's interest only increases further as it becomes an integral player in the local market, especially as the State provides important services or products and seeks higher objectives such as public health and welfare.

Applying strict scrutiny to *Reeves, Inc. v. Stake* establishes that the exception holds. The State took part in the market as a distributor and manufacturer of cement for all in-state and out-of-state contractors.[209] When cement shortage became a growing concern, the State consciously chose only to sell to in-state contractors to ensure their continued production for the economic welfare of the state.[210] If South Dakota's cement plant was required to sell based on uniform criteria and regardless of the buyer's residence, North Dakota could simply subsidize the purchases in times of shortage and allow their companies to pay a premium over South Dakota purchasers, essentially bidding the South Dakota contractors out of business. This would not only destroy the state's market for cement and construction but also discourage State participation in markets subject to fluctuation or high barriers to entry.[211] The State's interest in supporting industry as a participant, separate from a regulator, is quite compelling and meets the rigor of strict scrutiny. The State's action in *Reeves*, providing cement to in-state contractors first in a time of shortage, is also narrowly tailored to serve the interests of the State. In *Reeves*, it only showed preference for in-state contractors when it was necessary to do so, thus limiting the discrimination based solely upon state lines. The State narrowly tailored the law to ensure continued production and the general public welfare of the state.

The same analysis of the State's interest applies in closer cases where the State may not be purely a market participant, but may also be acting as a market regulator. In those cases, the outcome hinges almost entirely on the determination of the purity of participation in the market and the lack of regulatory impact on the same market. Using rigid determinations under the current doctrine keeps a compelling State interest from consideration in closer cases. In a case such as *Davis*, where the State plays an active role in both fields, the distinction blurs, if not vanishes, in the analysis.[212] Strict

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[207] Reeves, Inc. v. Stake, 447 U.S. 429, 436 (1980) (quoting *Alexandria Scrap Corp.*, 426 U.S. at 810).

[208] *See, e.g., id.*

[209] *Id.* at 429.

[210] *Id.*

[211] Municipal fundraising has a high barrier to entry. Municipal bond issues overcome those hurdles and allow for State participation where there would otherwise be a challenging market. *See supra* Part II.

[212] *See* Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801, 1811–14 (2008); *see also supra* notes 123–28 and accompanying text.

scrutiny, on the other hand, accounts for those dual roles by adjusting the State's interest accordingly, allowing a State with an exceptionally compelling interest to fill both the role of a regulator and a participant.

V. A SECOND LOOK AT *DAVIS*

The most recent Dormant Commerce Clause case before the Supreme Court is from the October 2007 Term, *Department of Revenue of Kentucky v. Davis*.[213] As described above,[214] the *Davis* case involved a husband and wife, residents of Kentucky, who owned municipal bonds issued by Kentucky and several other states.[215] As a result, Kentucky taxed their out-of-state holdings, yet exempted their in-state municipal bonds.[216] Under current Dormant Commerce Clause doctrine, the case turns on whether the State is a regulator for the taxation of the bonds, or a participant for issuing the bonds. That distinction fails to account for the State's interests in issuing the bonds for public works projects and maintaining financial security. In a strict scrutiny regime, the interest of the State is compelling and narrowly tailored sufficiently to achieve their ends, finding the tax exemption does not violate the Dormant Commerce Clause.

A. Under a New Standard

Analysis of *Davis* under this Note's proposed new standard of strict scrutiny requires considering the State's interest, the narrowness of the law, and whether it is the least burdensome alternative. Under the facts in *Davis*, the widespread use of dual taxation schemes, compelling benefits accrued to states and localities, and the necessity of low-cost financing each justify the State's compelling interest in issuing municipal bonds with differing state tax treatment. Moreover, the law is narrowly tailored to meet those benefits by encouraging the development of local bond markets and encouraging local investment. With the widespread use of these schemes in the vast majority of states, especially since their inception over two centuries ago,[217] the

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[213] 128 S. Ct. 1801.

[214] *See supra* Part I.

[215] Davis v. Dep't of Ky., 197 S.W.3d 557, 560, *rev'd*, 128 S. Ct. 1801 (2008).

[216] KY. REV. STAT. ANN. § 141.010(10)(c) (West 2006); *see supra* notes 11–15 and accompanying text.

[217] The Court almost appeared to decide the case on the sheer fact that the policies and statutes had been in place for hundreds of years. *Davis*, 128 S. Ct. at 1819. The Court quoted Justice Holmes from his opinion in *Paddell v. City of New York*, 211 U.S. 446, 448 (1908), stating, "The fact that the system has been in force for a very long time is of itself a strong reason . . . for leaving any improvement that may be desired to the legislature." *Id.* Justice Thomas similarly makes this point, stating, "The practice is thus both longstanding and widespread, yet Congress has refrained from preempting it." *Id.* at 1822 (Thomas, J., concurring).

benefits of tax exemption are widely available. Finally, the Kentucky taxation scheme, akin to nearly all state taxation schemes, provides the least burdensome alternative in terms of the burden on the public and the municipal financing cost burden on the localities. In each instance, the municipal bond taxation meets the standard of strict scrutiny and would be upheld under this Note's proposed new standard for Dormant Commerce Clause jurisprudence.

1. Compelling State Interest

The State's interest manifests itself quite differently depending on the doctrine used to analyze it. Current Dormant Commerce Clause doctrine, based on several distinct categorizations, begins with whether the statute discriminates against interstate commerce.[218] On its face, the taxation assessment only exempts those bond obligations from Kentucky, not those from sister states, making it appear to discriminate against bonds in interstate commerce.[219] A comparable analogy is from *City of Philadelphia v. New Jersey*, wherein the State prohibited garbage importation and the Court found the statute to be facially discriminatory because "[o]n its face, it imposes on out-of-state commercial interests the full burden of conserving the State's remaining landfill space."[220] Under the standard in *City of Philadelphia* and without considering the public benefit, the statute in Kentucky appears to be facially discriminatory.

Despite this determination, if the Court holds the statute to "benefit a clearly public facility, while treating all private companies exactly the same," then it can decide it does "not discriminate against interstate commerce for purposes of the dormant Commerce Clause."[221] Due to the public/private distinction, the Court in *United Haulers* stated that the flow control statute did not discriminate against interstate commerce.[222] Similarly, the statute in question clearly benefits public facilities by providing funding for public works projects, including school construction and road maintenance.[223] In *Davis*, the Court determined that the Kentucky taxation and

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[218] United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 127 S. Ct. 1786, 1793 (2007) ("To determine whether a law violates this so-called 'dormant' aspect of the Commerce Clause, we first ask whether it discriminates on its face against interstate commerce.").

[219] KY. REV. STAT. ANN. § 141.010(10)(c) (West 2006); *see supra* notes 11–15 and accompanying text.

[220] City of Philadelphia v. New Jersey, 437 U.S. 617, 628 (1978).

[221] *United Haulers*, 127 S. Ct. at 1795.

[222] *Id.*

[223] Justice Kennedy, in dissent in *Davis*, argued that it was essentially an endorsement of states' police power trumping congressional authority under the Commerce Clause. Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801, 1822 (2008) (Kennedy, J., dissenting). Justice Kennedy further argued that "[i]t is difficult to identify any state law that has come before us that would not meet the Court's description." *Id.* at 1824. The Court disputed this, noting that the inquiry was to determine "whether the preference was for the benefit of a government

bond-issuing scheme was most akin to *United Haulers*, that is to say that it favored the local government, all while treating private bond issuers, whether in- or out-of-state, identically.[224]

The market participant exception, under current doctrine and the plurality opinion in *Davis*, was a significant factor in its analysis due to Kentucky's dual role as a regulator and a participant in the municipal bond market.[225] In *New Energy Co. of Indiana v. Limbach*, the Court clearly stated that the "market-participation doctrine has no application" in cases over the "assessment and computation of taxes—a primeval government activity."[226] As such, the Court declared the exception dead whenever the State is acting solely as a taxing body and not in a competitive manner.[227] Since the State is acting as both a regulator through the imposition of taxes and a participant by issuing bonds in *Davis*, the exception applies under current Dormant Commerce Clause doctrine.[228] Justice Souter, writing for the plurality, rejected the argument that Kentucky's regulatory taxation power should be viewed in isolation, noting the Court had upheld the dual role of the State or local government previously in *White*.[229] Justice Souter argued that the market participation was an integral piece of the Court's holding, stating that "there is no ignoring the fact that imposing the differential tax scheme makes sense only because Kentucky is also a bond issuer."[230] In Justice Souter's analysis, the market participant doctrine was dispositive and sufficient to distinguish the differential tax treatment of municipal bonds from previous violations of the Dormant Commerce Clause.[231]

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fulfilling governmental obligations or for the benefit of private interests." *Id.* at 1810 n.9 (majority opinion).

[224] *Id.* at 1811. The Court noted that "the Kentucky tax scheme parallels the ordinance upheld in *United Haulers*: it 'benefit[s] a clearly public [issuer, that is, Kentucky], while treating all private [issuers] exactly the same.'" *Id.* (alteration in original). The Court also found *Davis* to be squarely in line with *United Haulers*—"Thus, *United Haulers* provides a firm basis for reversal." *Id.*

[225] *Id.* at 1811–14 (plurality opinion). Justice Souter also draws a distinction between *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997), in which the Court held that a "'tax exemption is not the sort of direct state involvement in the market that falls within the market-participation doctrine.'" *Davis*, 128 S. Ct. at 1814 n.17 (quoting *Camps Newfound*, 520 U.S. at 593). The tax exemption in *Camps Newfound* was not accompanied by market participation, such as issuing municipal bonds, as was the tax scheme in *Davis*, which was dispositive for the plurality's analysis. *Id.*

[226] 486 U.S. 269, 277 (1988).

[227] *Id.*

[228] *Davis*, 128 S. Ct. at 1812 (plurality opinion).

[229] *Id.* at 1813–14 (discussing White v. Mass. Council of Constr. Employers, Inc., 460 U.S. 204 (1983)).

[230] *Id.* at 1812 (plurality opinion).

[231] *Id.* "The Commonwealth has entered the market for debt securities, just as Maryland entered the market for automobile hulks and South Dakota entered the cement market." *Id.* (citations omitted).

Under strict scrutiny, the State's interest is only made stronger by its participation in the market as an issuer of municipal bonds. By looking only at the State's interest, it allows these close cases to be correctly decided as opposed to prohibiting State action in such a close case merely because they did not fit squarely into the round hole left vacant by the market participant exception. Despite the outcome under the categorized exception, the State's participation plays a role in the strength of its interest. The State's interests in maintaining municipal bond markets, promoting local and statewide public works projects, and stabilizing financing opportunities, as well as promoting the welfare and health of the public, are significant. The State's compelling interest remains even in close cases where the State may be partaking as a participant and a regulator in the same industry.

A State's interest in the welfare and benefits provided its citizens is unwavering and provides the basis for a compelling State interest under traditional strict scrutiny doctrine.[232] The State's interest primarily derives from benefits accrued to the State for the issuance of municipal bonds. With a burgeoning market for municipal debt that continues to expand each year, it is increasingly a source of fundraising for large capital projects, especially when backed by strong future cash flows from taxation and income earned from the project's results.[233] Schools, government offices, roads, and other state facilities are just a few of the many projects resulting from municipal bond issues.[234] These projects not only provide amenities to citizens, but also improve public welfare, public education, and public health directly as a result.[235] The Court in *Davis* essentially proves the strength of the State's interest—making the observation that the "indispensability of the current scheme to maintaining single-state markets serving smaller municipal borrowers" demonstrates that the State objectives are entirely unrelated to protectionism.[236] The *Davis* Court also noted the revenue loss typically exceeds the interest expense saved, further suggesting that the State's purpose

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[232] *See, e.g.*, United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 127 S. Ct. 1786, 1795 (2007) ("Unlike private enterprise, government is vested with the responsibility of protecting the health, safety, and welfare of its citizens.").

[233] *See generally* Michael Hudson, *Muni Bonds Poised to Stay Hot—Busy Public Issuers Join Hungry Investors to Help Add Fuel to Robust Market*, WALL ST. J., Jan. 12, 2007, at C6; Sara Seddon Kilbinger, *Investors, Seeking Roads to Riches, Turn to Infrastructure*, WALL ST. J., May 3, 2006, at B6.

[234] The Court in *Davis* notes these important benefits as well as the necessity of the municipal bond market. *Davis*, 128 S. Ct. at 1806. "The significance of the scheme is immense. Between 1996 and 2002, Kentucky and its subdivisions issued $7.7 billion in long-term bonds to pay for spending on transportation, public safety, education, utilities, and environmental protection, among other things." *Id.* (citation omitted).

[235] *See id.* at 1811. "Bond proceeds are thus the way to shoulder the cardinal civic responsibilities listed in *United Haulers*: protecting the health, safety, and welfare of citizens." *Id.* Throughout the Court's opinion and the plurality's musings, the strong public benefits played a significant role. *See, e.g.*, *id.* at 1811, 1815–17.

[236] *Id.* at 1817.

is not protectionism.[237] As the Court has shown in previous decisions, those public purposes—health, safety, and welfare—strengthen the argument that such a law is not violative of the Dormant Commerce Clause.[238]

Moreover, the State's interest also lies in assuring low cost financing to continue to be able to provide high quality services for its citizens. Municipal bonds traditionally price lower than comparable private issue bonds because of the tax exemption and the relative stability of municipality finances. The lower cost financing provides the State with the ability to borrow more money at lower cost for its capital improvements. The State's interest in the tax exemption of in-state bonds only increases with the lower cost of financing, which enables more resources for public benefit. In *Davis*, the State had a compelling governmental interest in assuring that low-cost financing continued so as to provide stability of its debt profiles for coming years, including its ability to pay the interest costs of its current debt. Furthermore, Kentucky also would face problems with rising costs in light of lower cost financing still available to other states.[239]

Perhaps more illustrative is the example of a small, rural town with limited resources for capital projects due to a small, and generally low-income, tax base. In a small town of 1000 residents with an average annual income of $25,000 per resident, the annual tax revenue is small, yet the amenities it is expected to provide—police, emergency services, schools, roads, and more—fail to change. This poses problems because as tax revenue remains low, smaller towns are unable to pay the costs of bond issues without the tax exemption. Consider a rural town with enough of a revenue base to pay interest and costs on $2.5 million in bonds at seven percent interest, but not a dime more in revenue to pay those costs.[240] With tax exemption, the bonds' interest rates remain at seven percent, but without the exemption, the rates may increase to nine percent, precluding the town from fundraising at the margin—roads may not be renovated, schools may not be built, and town programs may not be renewed. Small towns with low tax revenue bases suffer from the change in interest rate that accompanies any changes in tax treatment. In cases like this, the state and local

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[237] *Id.*

[238] *See supra* note 208 and accompanying text; *see also Davis*, 128 S. Ct. at 1817.

[239] Had the Court upheld the Kentucky Court of Appeals, it would have meant Kentucky's municipal bonds were no longer exempt because it struck down Kentucky's statute. Similarly, because no other state statute was in question, the vast majority of states are still able to exempt their bonds from state taxation, meaning their cost of municipal fundraising would be significantly lower than Kentucky's and this would disadvantage Kentucky in the national marketplace. If the Kentucky statute was unconstitutional, it would encourage similar challenges to other states with the same differential tax treatment.

[240] Leo: "How could you possibly remember that ten years ago there was a 188 million dollar debt increase off a 22 billion dollar deficit?" President Bartlet: "God, I was right?" Leo: "Ah, see, that's what I thought." *The West Wing: The Crackpots and These Women* (NBC television broadcast Oct. 20, 1999).

government's interest in ensuring the differential tax treatment is absolutely vital to the continuing financial success and advocacy of the public welfare, education, and health.

Significantly, a standard of strict scrutiny includes these interests, whereas the current doctrine ignores that which does not fit one of its distinctions. The strength of the State's interest in providing the taxation benefits evidently is irrelevant compared to whether it favors local government while treating all private entities even-handedly.[241] Strict scrutiny fulfills the Court's need for rigorous inquiry while also allowing State intervention where appropriate. In *Davis*, the State's interest is exceptionally strong and meets the strict scrutiny requirements.

2. Narrowly Tailored Legislation

Strict scrutiny requires narrowly tailored legislation supported by the State's compelling justification. In *Davis*, the State did not restrictively tailor the statute providing for tax exemption. The statute creates an exemption from state taxes clearly delineated on where the resident is taxed, excluding from exemption all those outside the state.[242] Despite this demarcation based on residence, the vast majority of other states have similar statutes and provide their own residents with reciprocity, exempting their own local and statewide municipal obligations.[243] Along similar lines, the Kentucky statute does not prohibit out-of-state individuals from purchasing Kentucky bonds, though it would lower the yield on the bond because they would be paying taxes on the interest in their home state.

From another vantage point, there are no feasible, less burdensome alternatives.[244] Another way to reduce borrowing costs, other than lower the effective interest rate paid, is to decrease the risk, but in the case of localities issuing bonds, the risk is exceptionally low already, with little room to improve.[245] A second alternative is to raise local taxes, but that also raises potential problems. The imposition would affect all, rather than those using the resource or those who self-select and accept the risk of the security issue.[246] It would also allow out-of-state residents to enjoy the benefits of the

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[241] *See, e.g.*, United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 127 S. Ct. 1786, 1795 (2007).

[242] KY. REV. STAT. ANN. § 141.010(10)(c) (West 2006).

[243] *See supra* notes 11–15 and accompanying text.

[244] The Court in *Davis* made no mention of potential alternatives to a bond-issuing and tax-exemption scheme. *See generally* Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801 (2008). The Court did, however, point out that a discriminatory law could only survive if it furthered "'a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.'" *Id.* at 1808 (quoting Or. Waste Sys., Inc. v. Dep't of Env'tl Quality of Or., 511 U.S. 93, 101(1994)).

[245] *See supra* Part II.D.

[246] Justice Stevens, in his concurrence, noted this point, stating that "state action that motivates the State's taxpayers to lend money to the State is simply not the sort of 'burden' on

higher taxes without having to pay the costs. Moreover, it would lower the total amount of funds that states could raise, thereby leaving municipalities in a worse position. A third alternative is for the State or locality to provide fewer services, at a lower quality, and with a longer time between repairs and updates—yet this would frustrate the State's compelling interest. Without any possible, less burdensome alternatives, the statute survives constitutional muster.

B. A Final Look at Davis

The new standard for Dormant Commerce Clause jurisprudence proposed in this Note, the formal adoption of strict scrutiny, provides a principled framework in which to analyze *Davis*. The current doctrine calls for distinctions along the lines of economic protectionism and the public/private nature of the statute, both of which fail to account for the contours of the State's undulating interest. By requiring a compelling state interest or justification for the statute, it allows all facets of the State's concern to be accounted for in the analysis. In *Davis* and under the proposed standard, the compelling state interest includes health and welfare of its citizens, the quality of public works projects, the low cost of public financing, and the stability of municipal bond markets. Those interests, otherwise ignored in current doctrine, become an important consideration in determining the State's interest. Moreover, the statute must also be narrowly tailored to fit that state interest. In *Davis*, there is no viable, less burdensome alternative than the current structure. Taxes would overburden those who did not use the resources provided and would prevent the town from raising the same amount of funds as under the current tax treatment. After analysis under this Note's standard, the statute in *Davis* remains valid.

CONCLUSION

Current Dormant Commerce Clause doctrine consists of several distinctions, each adjusted and used when deemed appropriate by the Court, as opposed to principled use. *United Haulers*, the latest in a string of cases providing more attenuated dichotomies, held that otherwise economically protectionist local ordinances could be saved by virtue of favoring local government, while treating private entities even-handedly.[247] Before *United Haulers* it was *Hughes*, *City of Philadelphia*, and *New Energy*, each creating its own distinctions and never truly falling in line with precedent, let alone each other. The fragmented, disjointed, and incoherent Dormant Commerce Clause doctrine now in use by the Court instills confusion in the wake of myriad patchwork

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interstate commerce that is implicated by our dormant Commerce Clause jurisprudence." *Davis*, 128 S. Ct. at 1820–21 (Stevens, J., concurring).

[247] United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 127 S. Ct. 1786, 1795 (2007).

decisions. A new, principled, and predictable standard will not only clarify the Court's decisions, but also provide guidance for those preparing, creating, and interpreting local statutes affecting interstate commerce.

This Note proposed a standard of strict scrutiny for application in Dormant Commerce Clause cases, requiring the State to demonstrate a narrowly tailored law supported by a compelling interest or justification.[248] This Note explains the virtues of strict scrutiny in this context—it provides a more principled approach from a wandering Court, properly explains much prior precedent, provides predictability and stability to local governments, and serves the goal of the Dormant Commerce Clause in expanding free markets. After rigorous analysis of the Court's prior decisions and State interests, it is evident that strict scrutiny not only provides a more principled approach, but also allows the Court to assess those close circumstances by the strength of interests and the fit of the law rather than by arbitrary classifications. The only solution to the Court's wanderings throughout Dormant Commerce Clause doctrine is by adopting a new standard and returning to principled jurisprudence.

[248] *See supra* Part IV.A.