

# THE SUPREME COURT'S MUNICIPAL BOND DECISION AND THE MARKET-PARTICIPANT EXCEPTION TO THE DORMANT COMMERCE CLAUSE

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## ABSTRACT

Does it violate the dormant Commerce Clause for a state to exempt interest earned on its own bonds, but no others, from income taxation? In a recent decision, the Supreme Court answered this question in the negative. Six members of the Court found the case controlled by the state-self-promotion exception to the dormancy doctrine's antidiscrimination rule. Three of those Justices, however, went further by also invoking the longstanding market-participant exception to sustain the discriminatory state tax break. This essay challenges that alternative line of analysis. According to the author, the plurality's effort to apply the market-participant principle: (1) invites a problematic reframing of basic market-participant rhetoric; (2) threatens ill-advised changes in longstanding Commerce Clause doctrine; and (3) injects far-reaching uncertainty into an already complex field of constitutional law. For all these reasons, a majority of the Court should reject the plurality's approach, and lower courts should refuse to follow it in the meantime.

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## INTRODUCTION

A major case of the Supreme Court’s most recent term presented a vexing constitutional question: Can a state provide an income tax exemption for interest paid on bonds issued by it, but not for interest paid on other bonds, including bonds issued by sister states? In *Department of Revenue of Kentucky v. Davis*,<sup>1</sup> the Court ruled that this form of state tax relief – despite its obvious favoritism of intrastate

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<sup>1</sup> 128 S. Ct. 1801 (2008).

transactions – did not offend the ban on discrimination against interstate commerce embedded in the so-called “dormant Commerce Clause.”<sup>2</sup>

Justice Souter wrote the Court’s controlling opinion. That opinion was controlling only in part, however, because one of the two rationales he offered did not command a majority vote. The dispositive analysis was set forth in Part IIIA, which was joined in full by Chief Justice Roberts and Justices Stevens, Scalia, Ginsburg, and Breyer.<sup>3</sup> There, Justice Souter reasoned that the constitutionality of Kentucky’s exemption for in-state public bond interest followed easily from the Court’s recent decision in *United Haulers Association, Inc. v. Oneida-Herkimer Solid Waste Management Authority*.<sup>4</sup> In Part IIIB of his opinion, Justice Souter advanced the alternative rationale that the Kentucky program was sustainable in any event under the longstanding “market participant exception” to the dormant Commerce Clause.<sup>5</sup> This portion of the opinion was joined only by Justices Stevens and Breyer. The other three Justices who had joined Part IIIA saw no need to go beyond reliance on *United Haulers*, accordingly declined to sign onto Part IIIB, and thereby deprived that portion of the opinion of binding precedential force.<sup>6</sup> As a result, the impact of Justice Souter’s market-participant analysis in *Davis*, for now, remains undetermined.

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<sup>2</sup> *Id.* at 1802. For general treatments of the dormant Commerce Clause, see BORIS I. BITTKER, BITTKER ON THE REGULATION OF INTERSTATE AND FOREIGN COMMERCE §§ 6-1 to 10-5 (1999); ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 401-34 (2d ed. 2002); DAN T. COENEN, CONSTITUTIONAL LAW: THE COMMERCE CLAUSE 209-342 (2004); LAWRENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 1021-1102 (3d ed. 2000).

<sup>3</sup> *Davis*, 128 S. Ct. at 1810-11.

<sup>4</sup> 550 U.S. 330 (2007).

<sup>5</sup> *Davis*, 128 S. Ct. at 1811-15. For some of the many discussions of the market-participant exception in the legal literature, see Thomas K. Anson & P.M. Schenkkan, *Federalism, the Dormant Commerce Clause, and State-Owned Resources*, 59 TEX. L. REV. 71 (1980); Theodore Blumoff, *The State Proprietary Exception to the Dormant Commerce Clause: A Persistent Nineteenth Century Anomaly*, 1984 S. ILL. U. L.J. 73; Dan T. Coenen, *Untangling the Market-Participant Exemption to the Dormant Commerce Clause*, 88 MICH. L. REV. 395 (1989); Mark P. Gergen, *The Selfish State and the Market*, 66 TEXAS L. REV. 1097 (1988); Treg A. Julander, *State Resident Preference Statutes and the Market Participant Exception to the Dormant Commerce Clause*, 24 WHITTIER L. REV. 541 (2002); A. Dan Tarlock, *National Power, State Resource Sovereignty and Federalism in the 1980’s: Scaling America’s Magic Mountain*, 32 U. KAN. L. REV. 111 (1983); Michael Wells & Walter Hellerstein, *The Government-Proprietary Distinction in Constitutional Law*, 66 VA. L. REV. 1073 (1980); Norman R. Williams, *Taking Care of Ourselves: State Citizenship, the Market, and the State*, 69 OHIO ST. L.J. 469 (2008).

<sup>6</sup> Both Chief Justice Roberts and Justice Scalia were explicit on this point. In a short separate opinion, the Chief Justice observed that “the case is readily resolved by last Term’s decision in *United Haulers*”; “[a] majority of the Court shared that view”; and

This essay advances the argument that the three Justices who came together in Part IIIB of the *Davis* opinion took a series of wrong turns. The argument proceeds in three steps. Part I of this essay frames the discussion by identifying just what the Court held, and did not hold, when it embraced a new state-self-promotion exception to the dormant Commerce Clause antidiscrimination rule in *United Haulers* and Part IIIA of *Davis*.<sup>7</sup> Part II turns to the market-participant doctrine and undertakes a wide-ranging critique of the portion of Justice Souter's opinion in which he and his two colleagues applied that doctrine to Kentucky's taxing scheme. Part III builds on Part II by demonstrating why an embrace of Justice Souter's market-participation analysis would, at the very least, have the harmful effect of injecting needless new uncertainties into an already complex field of law.

As this review demonstrates, adoption of the market-participant analysis advanced by Justice Souter would bring much mischief to future judicial decisionmaking. Indeed, endorsement of that analysis could dramatically narrow existing safeguards of our economic union, including by spurring on abandonment of central and salutary features of current dormant Commerce Clause case law.<sup>8</sup> Faced with these risks, the Court should repudiate section IIIB of Justice Souter's opinion at its first opportunity. In the meantime, lower courts should pay no heed to the plurality's novel – and dangerous – market-participant analysis.

## I. *DAVIS* AND *UNITED HAULERS*

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“[t]hat being the case, I see no need to proceed to the alternative analysis in Part III-B.” 128 S. Ct. at 1821. In similar fashion, Justice Scalia wrote: “I do not join Part III-B of the opinion of the Court because I think Part III-A adequately resolves the issues.” *Id.* In yet another separate opinion, Justice Thomas voted with the majority to uphold the tax exemption (while not joining its opinion) based on the theory that the dormant Commerce Clause principle is illegitimate and should never be applied. *Id.* at 1821-22. Justice Kennedy, joined by Justice Alito, filed a dissenting opinion, *id.* at 1822-30, which critiqued (among other things) Justice Souter's market-participant analysis.

<sup>7</sup> For a comprehensive discussion of the newly minted state-self-promotion rule, see Dan T. Coenen, *Where United Haulers Might Take Us: The Future of the State-Self-Promotion Exception to the Dormant Commerce Clause Rule* (unpublished manuscript, on file with author).

<sup>8</sup> See *infra* notes 66-69 and accompanying text (discussing effect on tax cases), notes 83-87 and accompanying text (discussing effect on the Court's seminal ruling in the *Baldwin* case), notes 91-93 and accompanying text (discussing effect on downstream-restraint cases such as *South-Central Timber*), notes 96-99 and accompanying text (discussing effect on potential monopoly limitation on the market-participant doctrine), notes 106-08 and accompanying text (discussing distinction between traditional and non-traditional state activity in applying the market-participant exception), and notes 111-13 and accompanying text (discussing effect on use of *Pike* balancing test in state-self-promotion cases).

At the heart of the Court's treatment of the 2008 *Davis* case lay its 2007 decision in *United Haulers*. There, the Court upheld municipal ordinances that required the delivery of all locally generated solid waste to a government-run waste transfer station, thus excluding private firms that operated in neighboring states from competing in that segment of the local waste market. Distinguishing its earlier decision in *C & A Carbone v. Town of Clarkstown*,<sup>9</sup> the Court in *United Haulers* reasoned that rules that require local citizens to use locally provided *government* services – as opposed to services provided by local *private* firms – do not involve the sort of “protectionism” that triggers strict dormant Commerce Clause review.<sup>10</sup> At the least, the Court explained, states enjoy this form of state-self-promotion immunity when they favor themselves in carrying out such “traditional governmental activities” as waste disposal.<sup>11</sup> Simply put, the Court in *United Haulers* concluded that discrimination for dormant Commerce Clause purposes is not present when a state acts only to “benefit a clearly public facility, while treating all private companies exactly the same.”<sup>12</sup>

In Part IIIA of his opinion in *Davis*, Justice Souter relied on this principle to validate Kentucky's tax break for income produced by in-state, but only in-state, public bonds.<sup>13</sup> *United Haulers* controlled, in the view of a majority of the Court, because Kentucky had advantaged only itself when it established special tax rules for municipal bonds, while treating in identical fashion all other participants in the bond market.<sup>14</sup> Indeed, the result in *Davis* “follow[ed] a fortiori” from *United Haulers* because – even more so than the operation of waste transfer stations – “the issuance of debt securities to pay for public projects is a

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<sup>9</sup> 511 U.S. 383 (1994).

<sup>10</sup> *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1796 (2007). For discussion on *United Haulers* and its relation to the Court's earlier *Carbone* decision, see generally Brannon P. Denning, *Reconstructing the Dormant Commerce Clause*, 50 WM. & MARY L. REV. 417, 469-75 (2008); Kenneth L. Karst, *From Carbone to United Haulers: The Advocate's Tales*, 2007 SUP. CT. REV. 237 (2007); Kylie Dummett, Note, *Carbone v. United Haulers: Local Environmental Regulation Gains Headway While the United States Supreme Court “Trashes” Judicial Precedence*, 12 GREAT PLAINS NAT. RESOURCES J. 185 (2008).

<sup>11</sup> *United Haulers*, 127 S. Ct. at 1796.

<sup>12</sup> *Id.* at 1795.

<sup>13</sup> *Dep't of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1810-11 (2008).

<sup>14</sup> *Id.* at 1811. The term “municipal bonds” is commonly – and loosely – used to describe all bonds issued by a state and any subunit of a state, including but not limited to municipalities. In this essay, the terms “municipal bonds” and “public bonds” are used interchangeably.

quintessentially public function, with [a] venerable history.”<sup>15</sup> Justice Souter emphasized that “any notion of discrimination assumes a comparison of substantially similar entities.”<sup>16</sup> He went on to declare that a state involved in raising revenue to support its own operations “does not have to treat itself as being ‘substantially similar’ to the other bond issuers in the market.”<sup>17</sup>

The Court’s reasoning in Part IIIA is not immune from criticism,<sup>18</sup> but identifying shortcomings in that analysis goes beyond

<sup>15</sup> *Id.* at 1810 (noting that, for this reason, the “apprehension in *United Haulers* about ‘unprecedented . . . interference’ with a traditional government function is just as warranted here”).

<sup>16</sup> *Id.* at 1811 (quoting *United Haulers*, 127 S. Ct. at 1795).

<sup>17</sup> *Id.* *Davis* has triggered much scholarly analysis. Some treatments predated the decision. See, e.g., Linda M. Beale, *The Tax Exemption for Home State Bonds, Misguided Though It May Be, Should Not Be Considered to Violate the Dormant Commerce Clause*, 26/2 A.B.A. SEC. OF TAX’N NEWS Q. 11 (Winter 2007); Robert J. Firestone, *Davis v. Kentucky: A Logical Application of the Market Participant Doctrine*, 46 ST. TAX NOTES 237 (2007); Bradley W. Joondeph, *Practical Consequences, Institutional Competence, and the Kentucky Bond Case*, 46 ST. TAX NOTES 267 (2007); Joel Michael, *Department of Revenue of Kentucky v. Davis: Implications for State Tax and Debt Policy and the Dormant Commerce Clause*, 45 ST. TAX NOTES 753 (2007); Alan D. Viard, *The Dormant Commerce Clause and the Balkanization of the Municipal Bond Market*, 46 ST. TAX NOTES 241 (2007); Edward A. Zelinsky, *Davis v. Department of Revenue: The Incoherence of Dormant Commerce Clause Nondiscrimination*, 44 ST. TAX NOTES 941, 942-44 (2007); Adam Pekor, Note, *Department of Revenue v. Davis: Why the Supreme Court Should Strike Down the Differential Tax Treatment of In-state and Out-of-State Municipal Bonds*, 60 TAX LAW 807, 814 (2007). Other treatments came in the wake of the *Davis* ruling. See, e.g., 1 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, *STATE TAXATION* ¶ 4.13 [2] [e] (3d ed. 2000 & Com. Supp. 2008); Jennifer Carr & Cara Griffith, *Was Davis Outcome-Based Jurisprudence*, 48 ST. TAX NOTES 663 (2008); Dolores Gregory, *A Contrarian’s View of the Holding in Kentucky v. Davis: Opening the Door to ‘Economic Balkanization’ in the States*, 15 MULTISTATE TAX REP. 372 (2008); Eugene W. Harper, Jr., *Davis Redivivus: The Futility of Utility*, 119 TAX NOTES 1276 (2008); Steve R. Johnson, *What Davis Means for Constitutional and Statutory Interpretation*, 48 ST. TAX NOTES 877 (2008); Alan D. Viard, *Selective Private Activity Bond Exemption Issue Still Unresolved*, 119 TAX NOTES 1017 (2008); Alan D. Viard, *U.S. Supreme Court Upholds Balkanization for some, but not all Bonds*, 48 ST. TAX NOTES 889 (2008); Leading Cases, *Dormant Commerce Clause – State Taxation of Municipal Bonds*, 122 HARV. L. REV. 276 (2008).

<sup>18</sup> See e.g., Coenen, *supra* note 7, at \_\_\_ (identifying ways in which Court’s ruling in *Davis* went beyond its ruling in *United Haulers*); Brian Galle & Ethan Yale, *Muni Bonds and the Commerce Clause After United Haulers*, 115 STATE TAX NOTES 1037 (2007) (stating, prior to the Court’s decision in *Davis*, that if the facts of *United Haulers* were held to control, it would be a “significant extension of [the] ‘state-run business’ exception from that case”); Brian Galle & Ethan Yale, *Can Discriminatory State Taxation of Municipal Bonds Be Justified?*, 117 STATE TAX NOTES 153 (2007) (same). But see Julie Muething, Comment and Casenote, *An Analysis of the Disparate Tax Treatment of Municipal Bonds: Department of Revenue of Kentucky v. Davis*, 75 U.

the purposes of this essay. Instead this essay focuses on Part IIIB, in which Justice Souter shifted attention away from a direct application of *United Haulers* to the construction of an alternative defense of the Kentucky tax exemption based on the market-participant doctrine. That alternative defense, as the ensuing analysis shows, is rife with difficulties.

## II. *DAVIS* AND THE MARKET-PARTICIPANT DOCTRINE

In the first sentence of Part IIIB, Justice Souter posited that “[t]his case, like *United Haulers*, may also be seen under the broader rubric of the market participation doctrine.”<sup>19</sup> In support of this pronouncement, Justice Souter first asserted that the state had engaged in both market participation (by issuing bonds) and market regulation (by imposing a discriminatory tax). He then expressed concern that the challengers of the Kentucky exemption had erred in focusing solely on the regulatory features of Kentucky’s behavior. According to Justice Souter, the Davises had ignored the critical fact that “regulation by taxation here goes hand in hand with market participation by selling bonds.”<sup>20</sup> More particularly, Justice Souter claimed that upholding the discriminatory tax because of its linkage to the state’s marketing of bonds reflected a logical application of the Court’s market-participant precedents, particularly *Hughes v. Alexandria Scrap Corp.*<sup>21</sup> and *White v. Massachusetts Council of Construction Employers, Inc.*<sup>22</sup> Indeed, in Justice Souter’s view, “*Alexandria Scrap* and *White* can be followed only by rejecting the Davises’ argument that Kentucky’s regulatory activity should be viewed in isolation as Commerce Clause discrimination.”<sup>23</sup>

Justice Souter made three questionable moves in constructing the market-participant analysis outlined in the preceding paragraph. First, he put forward the surprising suggestion that *United Haulers* is properly viewed as a market-participant case. Second, he greatly overstated the relevance of the Court’s market-participant precedents to the issue presented in *Davis*. Third, he set forth an analysis that opens the door to both confusion and error in future applications of the

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CIN. L. REV. 1711, 1732-33 (2007) (arguing, prior to *Davis*, that Supreme Court should uphold Kentucky’s disparate tax treatment of municipal bonds under *United Haulers*).

<sup>19</sup> *Davis*, 128 S. Ct. at 1811.

<sup>20</sup> *Id.* at 1812.

<sup>21</sup> 426 U.S. 794 (1976).

<sup>22</sup> 460 U.S. 204 (1982).

<sup>23</sup> *Davis*, 128 S. Ct. at 1814.

dormant Commerce Clause. These risks arise in part because Justice Souter propounded a new and perplexing analytical rhetoric for this field of law. Even more problematically, adoption of his approach would threaten long-recognized principles that lie at the heart of the Court's dormant Commerce Clause jurisprudence.

A. *Section IIIB and the Miscasting of United Haulers*

Justice Souter's first error lay in his surprising suggestion that *United Haulers* was – or at least should be viewed as – a market-participant case. Indeed, Justice Souter opened his analysis in Part IIIB by proclaiming that “*United Haulers* ... may ... be seen under the ... rubric of the market participation doctrine.”<sup>24</sup> This statement was curious in part because Justice Souter elsewhere acknowledged that the Court in *United Haulers* had resolved the case “independently of the market participation precedents”<sup>25</sup> and had not placed that ruling “under the market participant umbrella.”<sup>26</sup> These latter descriptions of the Court's action in *United Haulers* were on target because the controlling opinion in that case made no mention of the market-participant rule, did not rely on the Court's market-participant precedents, employed a balancing analysis that does not operate in market-participant cases,<sup>27</sup> and never questioned the government defendants' concession that the market-participant doctrine had no application to the matter at hand.<sup>28</sup>

Most important, the *United Haulers* majority acted in this manner because the case did involve state market regulation of the purest sort. Under the program challenged in *United Haulers*, the relevant localities had (1) entered the market for the provision of waste disposal services by opening a waste transfer facility and (2) then also directly compelled every person within those localities to buy waste services solely from that facility under the threat of criminal fines and imprisonment.<sup>29</sup> While activity #1 involved market participation, activity #2 involved a classic form of market regulation because it coerced behavior by purely private economic actors; indeed, the law at issue in *United Haulers* involved precisely the same form of market

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<sup>24</sup> *Id.* at 1811.

<sup>25</sup> *Id.* at 1809.

<sup>26</sup> *Id.* at 1813.

<sup>27</sup> See *infra* notes 111-13 and accompanying text (discussing *United Haulers* and the *Pike* balancing test).

<sup>28</sup> See *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1806 (2007) (Alito, J., dissenting) (noting governments' concession that the market-participant doctrine was inapplicable to that case).

<sup>29</sup> *Id.* at 1791.

regulation that the Court had invalidated as impermissibly discriminatory in its earlier ruling in *Carbone*.<sup>30</sup>

Confronted with this complication, Justice Souter advanced the idea in *Davis* that even the starkest form of market regulation will escape the grip of the dormant Commerce Clause when it “goes hand in hand” with a permissible form of state market participation.<sup>31</sup> Contrary to Justice Souter’s suggestion, however, the Court’s prior cases lent no support to this view. In the seminal South Dakota cement plant case, *Reeves, Inc. v. Stake*,<sup>32</sup> for example, the Court spoke of the market-participant doctrine as vindicating “the ability of the States themselves to operate freely in the free market.”<sup>33</sup> South Dakota did just that when it chose to favor in-state purchasers, to the exclusion of would-be out-of-state purchasers, in selling cement produced by a state-owned facility.<sup>34</sup> The government in *United Haulers*, in contrast, was not merely “operat[ing] freely in the free market” because it went beyond simply identifying the subset of persons with whom it was willing to deal. Instead, it stripped otherwise autonomous private traders of their ability to operate “freely in the free market” by coercing them to deal only with it. Indeed, in making this move, the government not only regulated local waste generators and handlers; it also regulated potential out-of-state competitors by effectively stripping them of their preexisting liberty to sell their services to private waste generators located within the jurisdiction.<sup>35</sup>

Notwithstanding the inapplicability of the market-participant exception in *United Haulers*, the majority in that case concluded that the state’s coercive behavior should escape the sort of elevated scrutiny typically applied to laws that discriminate against out-of-state

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<sup>30</sup> See also *S. Cent. Penn. Waste Haulers Ass’n v. Bedford-Fulton-Huntingdon Solid Waste Auth.*, 877 F. Supp. 935, 946 (M.D. Pa. 1994) (rejecting market-participant argument of governmental waste-handling facility because flow control policies reflect the “regulatory powers [that government owners] possess as sovereigns [and] are not the types of measures which private participants in the market could implement”); *Waste Recycling, Inc. v. Se. Ala. Solid Waste Disposal Auth.*, 814 F. Supp. 1566, 1573 (M.D. Ala. 1993) (noting that the very term “flow control” indicates the city’s “primary purpose is to ‘control,’ not participate in, the flow of solid waste in the stream of commerce”).

<sup>31</sup> *Dep’t of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1812 (2008).

<sup>32</sup> 447 U.S. 429 (1980).

<sup>33</sup> *Id.* at 437.

<sup>34</sup> *Id.*

<sup>35</sup> *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1803 (2007) (noting that the state, in *Carbone* “depriv[ed] competitors, including out-of-state firms, of access to the market” (quoting *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 386 (1994))).

commercial concerns. The Court, however, made it clear that this ruling stemmed solely from a proper understanding of what state regulations involve, and do not involve, problematic “discrimination.”<sup>36</sup> In other words, the Court in *United Haulers* based the result in that case on a distinction drawn between discrimination and nondiscrimination, rather than a distinction drawn between market regulation and market participation. For this reason, Justice Souter’s recasting of *United Haulers* as a market-participant case entailed a radically revisionist treatment of that decision. It also invited a sweeping reappraisal of what forms of state conduct can qualify for protection under the market-participant doctrine.

#### B. Part IIIB and a Misreading of the Market-Participant Precedents

A second flaw in Justice Souter’s market-participant analysis involved his treatment of the Court’s market-participant precedents. In particular, Justice Souter indicated that a failure to view Kentucky’s tax exemption and bond sales as a unitary whole – and thus as protected by the market-participant exception – “would require overruling” the Court’s prior decisions in *White* and *Alexandria Scrap*.<sup>37</sup> As to *White*, Justice Souter explained:

*White* ... scrutinized a government acting in dual roles. The mayor of Boston promulgated an executive order that bore the hallmarks of regulation: it applied to every construction project funded wholly or partially by city funds (or funds administered by the city), and it imposed general restrictions on the hiring practices of private contractors, mandating that 50% of their work forces be bona fide Boston residents and setting

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<sup>36</sup> See *supra* notes 25-28 and accompanying text (reviewing basis of Court’s ruling in *United Haulers*).

<sup>37</sup> Dep’t of Revenue of Ky. v. Davis, 128 S. Ct. 1801, 1813 (2008). Even more exotic was Justice Souter’s observation that “if the Davises had their way, ... the market-participant doctrine would describe a null set (or maybe a set of one, see *Reeves*...)” *Id.* As we soon shall see, this statement is erroneous because non-application of the market-participant doctrine in *Davis* is easily squared with its earlier application of that doctrine in *White* and *Alexandria Scrap*. But, even if a refusal to apply the doctrine in *Davis* would require overruling both *White* and *Alexandria Scrap*, the market-participant doctrine would still operate in many cases, including cases far different from *Reeves*. See, e.g., *Am. Yearbook Co. v. Askew*, 339 F. Supp. 719 (M.D. Fla.) *aff’d*, 409 U.S. 904 (1972) (validating state’s discriminatory actions as a purchaser by way of a “buy local” law).

thresholds for minorities (25%) and women (10%) as well.... After speaking of “[t]he basic distinction ... between States as market participants and States as market regulators,” ... *White* did not dissect Boston’s conduct and ignore the former. Instead, the Court treated the regulatory activity in favor of local and minority labor as terms or conditions of the government’s efforts in its market role, which was treated as dispositive.<sup>38</sup>

There are many difficulties with this effort to portray *White* as relevant to – if not dispositive of – the issue presented in *Davis*.<sup>39</sup> The essential difficulty, however, is plain to see. In *White*, the city imposed neither a forced-use rule (as in *United Haulers*) nor a discriminatory tax burden (as in *Davis*). Rather, Boston (just like South Dakota in *Reeves*) simply declared that it would engage in market transactions only with trading partners that met certain government-specified conditions – most significantly, the condition that hired contractors would ensure that 50% of all project workers were city residents. To be sure, the Court in *White* inquired whether the City’s imposition of this condition qualified as market regulation because of its effects on contracts entered into among privately owned general contractors, privately owned subcontractors, and individual private employees.<sup>40</sup> In the end, however, the Court concluded that the program in *White* did *not* involve market regulation because all project workers were, “in a substantial if informal sense, ‘working for the city,’” even if they were technically on the payrolls of private firms.<sup>41</sup> And because the employment of city workers by the city itself involved market participation – and *not* market

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<sup>38</sup> *Davis*, 128 S. Ct. at 1813 (quoting *White v. Mass. Council of Const. Employers, Inc.*, 460 U.S. 204, 207 (1982)).

<sup>39</sup> One curiosity involved Justice Souter’s highlighting of Boston’s treatment of minorities and women because that aspect of the city’s action was in no way at issue in the *White* case. Another curiosity involved Justice Souter’s suggestion that embodiment of the city’s contracting requirements in an executive order with continuing effect warranted characterizing those requirements as “regulatory” in nature. It is not unusual, after all, for private firms to establish ongoing policies (which may well be formally promulgated by the firm’s chief executive officer) that define those persons with whom the firm will contract. Banks, for example, often establish ongoing eligibility requirements with respect to what prospective borrowers do and do not qualify for loans. The establishment of such ongoing eligibility requirements by private firms, however, would never be thought of as a form of “regulation.”

<sup>40</sup> See *White*, 460 U.S. at 211 n.7 (addressing Justice Blackmun’s argument in dissent that the case involved state action that “regulates employment contracts”).

<sup>41</sup> *Id.*

regulation – the Boston hiring preference presented no problem under the dormant Commerce Clause.

Put another way, the Court perceived the key question in *White* to be whether “the city is regulating the market *rather than* participating in it,” or (to put the same point another way) “participating in the market, *rather than* acting as a market regulator.”<sup>42</sup> It thus made no sense for Justice Souter to suggest in Part IIIB of *Davis* that the Court in *White* had “treated the regulatory activity in favor of local ... labor” as permissible because it was “joined ... intimately” with Boston’s participation in the market.<sup>43</sup> The whole point of the Court’s analysis in *White* was that market participation and market regulation are mutually exclusive categories, so that the market-participant exception by definition becomes inapplicable once it is determined that market regulation is present. Any doubt in this regard was removed by the Court’s follow-up decision in *United Building & Construction Trades Council v. Mayor of Camden*,<sup>44</sup> in which the Court declared that the controlling consideration in *White* was that Boston had acted “*solely* as a market participant.”<sup>45</sup>

There is another reason for concluding that *White* provided no meaningful guidance as to the proper analysis in *Davis*. The reason is that *White* and *Davis* involved fundamentally different dormant Commerce Clause issues. *White* presented the question whether Boston had reached through its immediate contractual relationship with general contractors to impose an impermissible “downstream regulation” regarding its general contractors’ and subcontractors’ relationships with other private parties.<sup>46</sup> *Davis*, however, did not involve anything resembling a downstream regulation because Kentucky simply afforded a tax break to people who held Kentucky bonds, irrespective of the

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<sup>42</sup> *White*, 460 U.S. at 210 (emphasis added); *id.* at 207 (emphasis added).

<sup>43</sup> Dep’t of Revenue of Ky. v. *Davis*, 128 S. Ct. 1801, 1813 (2008).

<sup>44</sup> 465 U.S. 208 (1984).

<sup>45</sup> *Id.* at 220. Indeed, the Court went on to justify the market-participant rule by reasoning that “[t]he Commerce Clause acts as an implied restraint upon state regulatory powers,” so that “[w]hen the State acts solely as a market participant, no conflict between state *regulation* and federal regulatory authority can arise.” *Id.* But of course, if a state is acting as both a market participant and a market regulator, then a conflict between state regulation and federal regulatory authority can arise. *See also id.* at 219 (recapitulating “distinction between the city acting as a market participant and the city acting as a market regulator”).

<sup>46</sup> *S. Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 99 (1984). Downstream restraints, according to one account, are restraints placed by one entity in the production to distribution chain with regard to other entities that “perform functions closer to end use.” *Anson & Schenkkan*, *supra* note 5, at 77 n.25. *See also Coenen*, *supra* note 5 at 465-73 (exploring downstream restraints in *White* and other cases).

market relationships those bondholders had with any private party.<sup>47</sup> In short, *White* was a case about the downstream-regulation limit on the market-participant exception to the dormant Commerce Clause rule. *Davis*, in contrast, was a case about whether a particular form of discriminatory taxation should be treated like other forms of discriminatory taxation for purposes of Commerce Clause restraints. As Part IIIA of the Souter opinion made clear, the discriminatory-tax issue lay in the shadow of *United Haulers*.<sup>48</sup> It did not, however, bear any close kinship to the issue presented in *White*.

Justice Souter also missed the mark when he invoked *Alexandria Scrap* as a proper progenitor of his newfangled market-regulation/market-participation linkage-based approach. In *Alexandria Scrap*, the Court upheld a Maryland program that had two key features. First, the state paid cash bounties for the processing of junk cars so as to remove eyesores from the Maryland landscape.<sup>49</sup> Second, the state created an advantage for local firms in accessing these state-made payments by imposing stricter documentation requirements on out-of-state junk car handlers than on their in-state counterparts.<sup>50</sup> In *Davis*, Justice Souter claimed that *Alexandria Scrap*, like *White*, supported a view of the market-participant doctrine that authorizes discriminatory regulation if that regulation is “part and parcel” of the state’s market participation.<sup>51</sup> As he put the point:

[I]n *Alexandria Scrap*, Maryland employed the tools of regulation to invigorate its participation in the market for automobile hulks. The specific controversy there was over documentation requirements included in a “comprehensive statute designed to speed up the scrap cycle.” ... Superficially, the scheme was regulatory in nature; but the Court’s decision was premised on its view that, in practical terms, Maryland had not only regulated but had also “entered into the market itself to bid up [the] price” of automobile hulks.<sup>52</sup>

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<sup>47</sup> *Davis*, 128 S. Ct. at 1805. The downstream restraint doctrine might apply if, for example, Kentucky afforded tax breaks only to persons who purchased state bonds through an in-state broker.

<sup>48</sup> See *supra* notes 14-18 and accompanying text.

<sup>49</sup> 426 U.S. at 797.

<sup>50</sup> *Id.* at 799.

<sup>51</sup> *Davis*, 128 S. Ct. at 1814.

<sup>52</sup> *Id.* at 1813 (citations omitted).

As with his description of *White*, Justice Souter’s description of *Alexandria Scrap* gives insufficient attention to the actual words and real reasoning of the case. To begin with, the “comprehensive” nature of Maryland’s statutory scheme<sup>53</sup> was beside the point in *Alexandria Scrap*. In fact, the Court focused its attention on whether the discriminatory documentation requirement, standing alone, violated the dormant Commerce Clause, so that the “comprehensive” treatment of junk cars did not bear on the Court’s analysis at all.<sup>54</sup> Of even greater significance, the Court in *Alexandria Scrap* in no way suggested that “Maryland had *not only* regulated but had *also* ‘entered the market itself.’”<sup>55</sup> Rather, the Court was emphatic in declaring that: “Maryland has *not* sought ... to regulate the conditions under which the [flow of junk cars] may occur. *Instead*, it has entered into the market to bid up their price.”<sup>56</sup> Thus, in *Alexandria Scrap* – just as in *White* – the linchpin of the Court’s analysis was that the state had acted *only* as a market-participant, and *not* as a market regulator, by spending its own money in a way that favored in-state traders.<sup>57</sup> There was no suggestion that the Court viewed Maryland’s choice of favored trading partners as a form of “regulation” that escaped constitutional extermination because of its nexus to separately identified market participation by way of the payment of cash bounties. Rather, the Court – with a solid grounding in conventional understandings – viewed the overall behavior of Maryland in both making payments and stipulating the conditions on which those payments would be made as companion elements of market participation.<sup>58</sup>

In fairness to Justice Souter, it is not unreasonable to describe *White* and *Alexandria Scrap* as cases that involve state regulation. Many economists, for example, view government subsidy programs, including the one at issue in *Alexandria Scrap*, as “regulatory” in nature

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<sup>53</sup> *Id.*

<sup>54</sup> See *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 804 (1976) (discussing whether the statutory amendment that added the documentation requirement was “the kind of action with which the Commerce Clause [was] concerned”).

<sup>55</sup> *Davis*, 128 S. Ct. at 1813 (quoting *Alexandria Scrap*, 426 U.S. at 806).

<sup>56</sup> See *Alexandria Scrap*, 426 U.S. at 806. In the same vein, the Court added that Maryland had not “interfered with the natural functioning of the interstate market...through burdensome regulation.” *Id.*

<sup>57</sup> See also *Reeves, Inc. v. Stake*, 447 U.S. 429, 436 (1980) (explaining that Court in *Alexandria Scrap* “characterized Maryland as a market participant, rather than as a market regulator”).

<sup>58</sup> See *supra* note 39 (discussing common business practice of private firms to establish eligibility requirements as they operate in the market).

because in purpose and effect they shape private marketplace behavior.<sup>59</sup> In like fashion, the state's efforts to induce the hiring of state residents by private firms in *White* could be seen as the very "essence of regulation."<sup>60</sup> In fact, Justice Blackmun – in a passage written in the *White* case and quoted with enthusiasm in Part IIIB of the *Davis* opinion – described the Boston program in exactly those terms.<sup>61</sup> The important point, however, is that Justice Blackmun wrote those words in a *dissenting* opinion. The majority in *White*, like the majority in *Alexandria Scrap*, took a foundationally different approach to the case. In the view of both of those majorities, the state had not engaged in regulatory action, but "solely" in marketplace behavior.<sup>62</sup> Thus, it is inaccurate in the extreme to say that the market-participant doctrine applied in either instance because the Court had concluded that the government's "commercial activities ... and ... regulatory efforts complemented each other."<sup>63</sup>

### C. Part IIIB and Dormant Commerce Clause Dangers

The foregoing discussion reveals how Justice Souter steered off course in dealing with key Commerce Clause precedents in Part IIIB of his *Davis* opinion. It may be, however, that his analytical miscues concerned only technical matters, so that the preceding discussion embodies only doctrinal hair-splitting of no practical importance. Do the flaws of Part IIIB pose genuine risks of harm to dormant Commerce Clause law? The answer to that question is an emphatic "yes" because Justice Souter's market-participant reasoning poses three significant dangers. First, that analysis involves a deeply problematic recrafting of the basic rhetoric of market-participant analysis. Second, there exists a

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<sup>59</sup> See, e.g., Dan T. Coenen, *Business Subsidies and the Dormant Commerce Clause*, 107 YALE L.J. 965, 1014 (1998) (noting that "the very purpose of subsidization is to regulate the flow of business by promoting in-state production"); Michael J. Pollele, *A Critique of the Market Participant Exception*, 15 WHITTIER L. REV. 647, 658 (1994) ("It is no more logical to say that a state has entered the market as a real buyer or seller when it uses subsidies than when it uses its normal regulatory powers to manipulate an existing market."); see also Gergen, *supra* note 5, at 1144 ("If downstream restraints are different from subsidies in any real respect, it is because their costs are hidden.").

<sup>60</sup> *White v. Mass. Council of Const. Employers, Inc.*, 460 U.S. 204, 219 (1982) (Blackmun, J., concurring in part and dissenting in part).

<sup>61</sup> *Id.* The Justice stated: "The power to dictate to another those with whom *he* may deal is viewed with suspicion and closely limited in the context of purely private economic relations. When exercised by government, such a power is the essence of regulation." *Id.* (internal citations omitted).

<sup>62</sup> See *supra* note 45 and accompanying text (quoting *United Building* case).

<sup>63</sup> *Davis*, 128 U.S. at 1813.

serious risk that this new rhetoric will reshape dormant Commerce Clause decisionmaking in undesirable ways. Third, an embrace of Justice Souter's methodology would at least inject new and far-reaching doctrinal uncertainties into this field of law.

### 1. *Market-Participant Rhetoric*

Prior analysis reveals two basic points about Part IIIB. First, Justice Souter stood ready to uphold Kentucky's discriminatory taxing scheme under the market-participant rubric, even after characterizing the challenged state action as involving market regulation. Second, Justice Souter saw no problem in making this move even though the Court had previously applied the exception only after concluding that the relevant state activity did *not* involve market regulation, but *only* market participation.<sup>64</sup>

The conclusion properly distilled from these two points is that Part IIIB in effect advances a dramatically new style of rhetoric for evaluating the application of the market-participant doctrine. Under this new rhetoric, discriminatory behavior can qualify for market-participant immunity, even when viewed as a form of market regulation. To be sure, in the view of Justice Souter, a discriminatory regulation can claim that immunity only if it is linked in a meaningful way to market participation. Also, to be sure, Justice Souter would be quick to insist that this meaningful-linkage requirement will counteract overuse of the market-participant exception – and resulting dilution of the dormant Commerce Clause principle – under the rhetoric he proposes.

Even so, words matter. And the shift in rhetoric that lies at the heart of Justice Souter's Part IIIB analysis would exert a gravitational pull in the direction of expanding the market-participant exception if it were embraced by the Court. Simply stated, a newly formulated rule that sometimes permits market regulation to qualify for a market-participant-based immunity must reach farther than the existing rule, which categorically forecloses the application of that immunity to any form of market regulation. The rhetoric of rules always shapes their operation. And Justice Souter's new rhetoric, in its very nature, invites an expansion of the market-participant exception and a reciprocal contraction of the otherwise operative scope of the dormant Commerce Clause rule.

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<sup>64</sup> See *supra* notes 39-45 and accompanying text (describing Court's perception of absence of market regulation in *White*); notes 55-58 and accompanying text (describing Court's perception of absence of market regulation in *Alexandria Scrap*).

## 2. *Market-Participant Mischief*

Just how would an endorsement of Justice Souter's new market-participant rhetoric affect dormant Commerce Clause decisionmaking? The opaqueness of Justice Souter's Part IIIB analysis precludes any certain answer to this question.<sup>65</sup> There can be no doubt, however, that that analysis threatens to alter the dormant Commerce Clause landscape in important ways. In particular, that analysis could well (a) lead to troubling shifts in the Court's traditional tax-discrimination jurisprudence; (b) alter results in market regulation cases as well; and (c) greatly expand the practical operation of the state-self-promotion principle first recognized in *United Haulers* and again applied in Part IIIA of *Davis*.

(a) *Dormant Commerce Clause Tax Law*. In Part IIIB of his *Davis* opinion, Justice Souter became the first member of the Court ever to suggest that some forms of discriminatory tax relief could find shelter under the "rubric of the market participation doctrine."<sup>66</sup> This analytical move may provide a new opening for those who have advocated dramatic revisions of dormant Commerce Clause tax law. Why? In part, because one leading critic, Professor Edward A. Zelinsky, has vigorously argued that local-industry-supporting tax exemptions, credits, and deductions (which historically have been invalidated) should be treated no differently than local-industry-supporting affirmative monetary subsidies (which historically have been upheld, including in *Alexandria Scrap*).<sup>67</sup> The centerpiece of Professor

<sup>65</sup> See *infra* notes 118-19 and accompanying text (touching on the range of questions raised by Part IIIB).

<sup>66</sup> Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801, 1811 (2008). See also *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 566 (1997) (finding market-participant exemption inapplicable to Maine law providing tax break to charitable organizations who catered to in-state residents); *New Energy Co. v. Limbach*, 486 U.S. 269, 277 (1988) ("A tax exemption is not the sort of direct state involvement in the market that falls within the market-participation doctrine."); cf. *Bacchus Imports v. Dias*, 468 U.S. 263 (1984) (invalidating tax exemption for locally produced spirits without even considering the market-participant doctrine).

<sup>67</sup> See Edward A. Zelinsky, *Restoring Politics to the Commerce Clause: The Case for Abandoning the Dormant Commerce Clause Prohibition on Discriminatory Taxation*, 29 OHIO N. U. L. REV. 29, 30 (2002) (asserting that because "tax credits may be identical to direct outlay subsidies" and because this fact adds great confusion and inconsistency to the dormant Commerce Clause, the Court needs to abandon the anti-discrimination principle in the context of state taxes); Edward A. Zelinsky, *Ohio Incentives Decision Revisited*, 108 TAX NOTES 1569 (Sept. 26, 2005) (seeking to rebut argument that subsidies are more tolerable because of the increased "legislative scrutiny" of them); Edward A. Zelinsky, *Are Tax Benefits Constitutionally Equivalent to Direct Expenditures*, 112 Harv. L. Rev. 379, 391 (1998). But see Brannon P. Denning, *Is the*

Zelinsky's analysis is that the economic effects of state monetary payments and so-called "tax expenditures" are functionally identical, so that there is no good reason to attach to them different legal effects.<sup>68</sup> In particular, building on Justice Souter's analysis in Part IIIB, Professor Zelinsky might say something like this: "Taxation may have a regulatory dimension, but tax relief is a subsidy, and thus a form of market participation. Justice Souter has said that the market-participant exception can apply when state market participation is linked to state market regulation. And under that principle, subsidy-like tax relief – which in practical effect involves just as much market participation as the subsidy program involved in *Alexandria Scrap* – should fall outside the dormant Commerce Clause rule."

The difficulty with this subsidy-is-like-tax-break approach is that it threatens to create a dormant Commerce Clause "exception" large enough to drive a truck through.<sup>69</sup> In *Bacchus Imports, Ltd. v. Dias*,<sup>70</sup> for example, the Court invalidated an exemption from Hawaii's wholesale liquor tax that was claimable only by vendors of locally manufactured fruit-wine.<sup>71</sup> Under the reasoning laid out above, however, the Court should have detected no constitutional problem because the tax break generated exactly the same financial consequences for the favored sellers that a legally unobjectionable affirmative monetary subsidy for those same sellers would have produced. Indeed,

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*Dormant Commerce Clause Expendable? A Response to Edward Zelinsky*, 77 *Miss. L.J.* 623, 636 (2007) (urging that "the differential treatment by the Court of taxes and subsidies [is not] inconsistent or incoherent").

<sup>68</sup> See Zelinsky, *Restoring Politics*, *supra* note 67, at 29; see also *Chem. Waste Mgmt. Inc. v. Hunt*, 504 U.S. 334, 351 (1992) (Rehnquist, C.J., dissenting) (viewing subsidies as equivalent to tax breaks); *Fireside Nissan, Inc. v. Fanning*, 30 F.3d 206, 216 (1st Cir. 1994) (detecting no practical difference between a tax break afforded to certain industries and "a 'direct' cash subsidy to those same industries"); *Carlson v. State*, 798 P.2d 1269, 1278 (Alaska 1990) (positing that paying out cash subsidies to in-staters seems "economically indistinguishable from imposing a facially equal tax on residents and nonresidents while making it effectively unequal by a system of credits and exemptions"); COENEN, *supra* note 2, at 297 (noting that "as an economic matter" direct subsidies and tax exemptions and expenditures are "functionally indistinguishable"); Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 *HARV. L. REV.* 705, 717 (1970) ("A dollar is a dollar--both for the person who receives it and the government that pays it, whether the dollar comes with a tax credit label or a direct expenditure label.").

<sup>69</sup> See Denning, *supra* note 67, at 625 (suggesting that, if taken to its logical end, Zelinsky's "critique and his solution . . . means the end" of the dormant Commerce Clause doctrine itself).

<sup>70</sup> 468 U.S. 263 (1984).

<sup>71</sup> The exemption also extended to sellers of okolehao, a brandy distilled from the root of an indigenous Hawaiian shrub. *Id.* at 265.

even protective tariffs may be seen as embodying a subsidy-like form of tax expenditure. After all, when a state taxes the in-state transfer or movement of only out-of-state goods, it might be viewed as taxing all goods, both in-state and out-of-state, while providing a subsidy-like tax exemption for in-state products. If the Court were to uphold tariffs on this ground, however, it would stand the dormant Commerce Clause on its head because tariffs represent the “paradigmatic example” of laws that abridge the constitutional principle of economic union.<sup>72</sup>

Without explicitly saying so, the Court in the past has dealt with this tension by drawing an unbreachable line between tax breaks (which have been automatically characterized as regulatory for dormant Commerce Clause purposes) and affirmative payments (which have been automatically characterized as non-regulatory and thus properly assimilated to market participation).<sup>73</sup> Justice Souter’s approach threatens to erase this line – or at least to blur it greatly – even though, as I have explained at length elsewhere, that line comports with powerful historical and political-process considerations.<sup>74</sup> To be sure, Justice Souter’s opinion purported to leave undisturbed the Court’s past tax-discrimination cases, which he distinguished from *Davis* on the ground that the tax breaks previously struck down by the Court favored private firms instead of the government itself.<sup>75</sup> But one can only wonder whether that distinction can endure, and how it will operate in practice, in light of Justice Souter’s ambitious recrafting of the market-participant doctrine.

The cause for wonder is heightened by Justice Souter’s treatment of *Camps Newfound/Owatonna, Inc. v. Town of Harrison*<sup>76</sup> in

<sup>72</sup> *W. Lynn Creamery v. Healy*, 512 U.S. 186, 193 (1994). See also Richard B. Collins, *Economic Union as a Constitutional Value*, 63 N.Y.U. L. REV. 43, 80 (1988) (citing tariffs as the “paradigm examples” of “categorical discrimination” barred by the Commerce Clause).

<sup>73</sup> See *W. Lynn Creamery*, 512 U.S. at 186 (invalidating state subsidy that operated as a de facto tax rebate or refund, even while seeming to recognize that freestanding subsidies are unobjectionable); *New Energy Co. v. Limbach*, 486 U.S. 269, 277 (1988) (invalidating sales tax credit provided to in-state producers of ethanol while distinguishing as permissible a direct subsidy for in-state producers). See generally Williams, *supra* note 5, at 479 (“To date, the Court has yet to uphold a discriminatory tax exemption or credit.”).

<sup>74</sup> See, e.g., Coenen, *supra* note 59, at 969 (“[F]our considerations – rooted in form, fairness, federalism, and political process – render subsidies less threatening to Commerce Clause values than economically comparable tax deductions, credits, and exemptions.”); see also GEOFFERY R. STONE ET AL., *CONSTITUTIONAL LAW* 300 (2d ed. 1991) (noting that outright subsidies have greater “political visibility” than tax expenditures or exemptions).

<sup>75</sup> *Dep’t of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1813-14 (2008).

<sup>76</sup> 520 U.S. 564 (1996).

footnote 17 of his opinion.<sup>77</sup> In that case, the Court struck down a property tax break afforded by Maine to non-profit entities that directed most or all of their services to state residents.<sup>78</sup> According to Justice Souter, this form of discriminatory tax relief differed from the tax break at issue in *Davis* for the following reason:

In *Camps Newfound*, the tax exemption was unaccompanied by any market activity by the State; it favored only private charitable institutions. We correctly rejected the argument that a tax exemption without more constitutes market participation. But we had no occasion to consider the scheme here, where a State employs a tax exemption to facilitate its own participation in the market.<sup>79</sup>

This passage raises a host of questions about when a discriminatory state tax break operates “without more” to favor “only” private entities and about whether the proper touchstone for review in hybrid market-participation/market-regulation cases is a strict “without more” test. Would the Maine tax break be permissible if, for example, the state itself had sold supplies or leased real estate to the resident-favoring entities involved in the *Camps Newfound/Owatonna* case? What if the state had contracted to pay fees on behalf of some users of the non-profit entities’ services, and the tax relief helped to ensure that those services would remain available? What if the state both granted tax breaks to and affirmatively subsidized resident-preferring non-profits? In any such case, it could not be said that “a tax exemption without more” was at work or that “the tax exemption was unaccompanied by any market activity by the state.”<sup>80</sup> It follows that these forms of linkage between state taxation and state market participation might trigger application of the market-participant exception under the view of Justice Souter. At the very least, Part IIIB of his opinion does not foreclose such an outcome. Any such result, however, would plow new doctrinal ground by departing from the “cardinal rule” that “[n]o state, consistent with the Commerce Clause,

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<sup>77</sup> *Davis*, 128 S. Ct. at 1814 n.17.

<sup>78</sup> *Camps Newfound/Owatonna*, 520 U.S. at 564.

<sup>79</sup> *Davis*, 128 S. Ct. at 1814 n.17.

<sup>80</sup> See *supra* notes 78-79 and accompanying text.

may impose a tax which discriminates against interstate commerce by giving a direct commercial advantage to local business.”<sup>81</sup>

(b) *Dormant Commerce Clause Regulatory Law*. The dormant Commerce Clause operates in two separate hemispheres – one occupied by state and local tax laws and one occupied by non-tax regulatory measures.<sup>82</sup> As we have just seen, Part IIIB could open the door to a significant reformulation of how the dormant Commerce Clause operates in tax cases.<sup>83</sup> No less important, Justice Souter’s market-participant analysis could disrupt settled jurisprudence in the state-regulation arena.

In *Baldwin v. G.A.F. Seelig, Inc.*,<sup>84</sup> for example, the Court invalidated a New York law that established minimum wholesale prices for all locally sold milk, as applied to the products of out-of-state dairy farmers. The Court’s concern was that this regulatory intervention had effects that paralleled those of protective tariffs.<sup>85</sup> The difficulty was that the measure, by equalizing prices, deprived out-of-state producers of efficiency-generated opportunities to undersell in-state competitors.<sup>86</sup> In reflecting on *Baldwin* in Part IIIB, Justice Souter noted that “[s]tates that regulated the price of milk ... did not keep herds of cows or compete against dairy producers for the dollars of milk drinkers.”<sup>87</sup> Did the plurality mean to suggest that *Baldwin* would have come out differently if local governments had owned herds? Any number of herds? A substantial number of herds? Even if the tariff-like effects of the challenged pricing scheme would have been the same as in *Baldwin* with respect to shielding local private herd owners from out-of-state competition? It is noteworthy in this regard that Justice Souter stressed that “[t]he Commonwealth enacted its tax code with an eye toward making some or all of its bonds more marketable.”<sup>88</sup> If a state in similar fashion passes a minimum price rule for the specific purpose of making its own milk “more marketable,” will its program withstand dormant

<sup>81</sup> *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 268 (1984) (quoting *Boston Stock Exch. v. State Tax Comm’n*, 429 U.S. 318, 329 (1977) and *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959)).

<sup>82</sup> See, e.g., Dan T. Coenen, *State User Fees and the Dormant Commerce Clause*, 50 VAND. L. REV. 795, 808-809 (1997) (describing these two categories of cases and outlining the different doctrinal approaches taken to them by the Court).

<sup>83</sup> See *supra* notes 66-81 and accompanying text.

<sup>84</sup> 294 U.S. 511 (1935).

<sup>85</sup> *Id.* at 521-22; see also *W. Lynn Creamery v. Healy*, 512 U.S. 186, 194 (1994) (discussing the *Baldwin* decision).

<sup>86</sup> See *W. Lynn Creamery*, 512 U.S. at 194 (stating that minimum price regulation neutralized “the advantage possessed by lower cost out-of-state producers”).

<sup>87</sup> *Dep’t of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1812 (2008).

<sup>88</sup> *Id.* at 1814.

Commerce Clause challenge even though it simultaneously protects local private milk producers from competitive challenges posed by out-of-state farmers?

An apologist for Justice Souter might criticize the foregoing analysis as unduly alarmist.<sup>89</sup> The some-herds-are-owned-by-the-state hypothetical, so the argument goes, is easily distinguished from *Davis* on the ground that a minimum price rule would give a leg up not only to the state's own commerce, but to private in-state commercial actors as well. This observation, however, simply ignores the all-important question. That question concerns how far Part IIIB of the Souter opinion goes beyond Part IIIA in safeguarding hybridized state commercial and regulatory activity from dormant Commerce Clause attack. In the end, an endorsement of the protean linkage principle put forward in Part IIIB creates an issue in every case as to how much linkage justifies how much discrimination whenever state regulation and state commercial activities are conjoined.

Another illustration of this difficulty comes from *South-Central Timber Development, Inc. v. Wunnicke*.<sup>90</sup> There, the Court confronted the question whether Alaska could condition sales of its timber on the buyer's agreement to process that timber within the state. In invalidating Alaska's action, a four-Justice plurality deemed the market-participant exception inapplicable on the ground that the state was working through a transaction made in one market (that is, the market for timber sales) to effectively "regulate" activity in another market (that is, the market for timber processing) by way of a contractual condition.<sup>91</sup> On Justice Souter's view, however, affixation of the "regulation" label to this set of facts would not foreclose application of the market-participant doctrine.<sup>92</sup> Indeed, he might well say that an overruling of *South-Central Timber* should follow *a fortiori* from *United Haulers*. Part IIIB indicates, after all, that Justice Souter stood ready to validate

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<sup>89</sup> Indeed, Justice Souter might well level such a criticism himself. *See id.* at 1819 (describing as "alarmism" dissenters' expression of concern that validating Kentucky's differential tax scheme would undermine the purposes of the Commerce Clause).

<sup>90</sup> 467 U.S. 82 (1984).

<sup>91</sup> *See id.* at 97 (concluding that the "market regulator" label applied because "[t]he limit of the market-participant doctrine must be that it allows a State to impose burdens on commerce within the market in which it is a participant, but allows it to go no further"). *See generally* Polelle, *supra* note 59, at 675-76 (expressing concerns regarding downstream restraints because of restrictions placed on otherwise free-trade in the free market); Williams, *supra* note 5, at 510-517 (broadly exploring "downstream restraint" concept while noting that the "constitutionality of downstream restraints is a complex question" not susceptible to "categorical answers").

<sup>92</sup> *See supra* note 31 and accompanying text.

under the market-participant doctrine even the fully coercive state regulation at issue in *United Haulers* due to its linkage to state sales of waste services.<sup>93</sup> Thus, it is hard to see why he would not even more readily validate the non-coercive form of state regulation imposed by way of a mere contractual condition in a case like *South-Central Timber*. It bears emphasis that this line of reasoning would have effects that reach well beyond the overruling of *South-Central Timber* itself. It would require abandonment of any sort of “downstream restraint” limitation on the market-participant exception because every application of that limitation involves invalidation of a *de facto* regulation imposed by way of mere contractual condition.

Justice Souter’s approach would raise other questions as well. In a case of no small interest to California football fans, for example, a state court held that the market-participant exception did not shelter an exercise of the eminent domain power to keep the Oakland Raiders in Oakland.<sup>94</sup> Would Justice Souter reject this result? Perhaps he would because there can be no doubt that the government’s regulatory move in compelling a sale went “hand in hand” with its attempted marketplace act of buying the Raiders franchise.<sup>95</sup>

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<sup>93</sup> See *supra* note 24 and accompanying text.

<sup>94</sup> See *City of Oakland v. Oakland Raiders*, 220 Cal. Rptr. 153 (Cal. Ct. App. 1985). The trial court had found that the City of Oakland’s attempt to force a sale of the Oakland Raiders franchise had violated the dormant Commerce Clause. See *id.* at 154. As a defense, the City of Oakland argued on appeal that their purchase of the Oakland Raiders franchise fell within the market-participant exception. The California Court of Appeal found that the market-participant exception did not apply because the city’s action did not involve a voluntary transaction, but instead a sale coerced by way of the power of eminent domain. *Id.* at 156.

<sup>95</sup> *Dep’t of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1812 (2008). An intriguing question is whether, apart from the market-participant exception, the state-self-promotion principle of *United Haulers* would shelter Oakland’s action, despite the blockade it put on the franchise’s interstate sale. *United Haulers* may control because it shares a key feature with the *Oakland Raiders* case: In both settings, the municipality forced local traders to deal with it, thus thwarting the possibility of engaging in commerce across state lines. See *supra* notes 29-30 and accompanying text. One possible distinction is that condemnation of a football team does not, like a garbage regulation, involve a “traditional government function.” See *supra* note 11 and accompanying text (quoting *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1796 (2007)). There is, however, no “traditional functions” limit on the operation of the market-participant doctrine. See *infra* notes 104-07 and accompanying text. In short, under Justice Souter’s approach, the regulation at issue in *Oakland Raiders* might well escape constitutional invalidation under that doctrine even if it would not be carried to safety by *United Haulers*.

In another line of cases, lower courts have suggested that there exists a monopoly exception to the market-participant doctrine.<sup>96</sup> On this view, for example, *Reeves* might well come out differently if the would-be Wyoming cement buyer could show that there existed no market substitutes for South Dakota's state-made product or opportunity to create market substitutes due to South Dakota's monopoly position.<sup>97</sup> Would Justice Souter agree? On one view, his analysis should foreclose recognition of any monopoly exception to the market-participant doctrine. After all, Justice Souter stood ready to affix the market-participant label to the rule at issue in *United Haulers*<sup>98</sup> even though that rule vested a monopoly position in a state entity by mandating that all local citizens deal with it and no one else.<sup>99</sup> It should follow, according

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<sup>96</sup> See e.g., *W. Oil & Gas Ass'n v. Cory*, 726 F.2d 1340, 1343 (9th Cir. 1984), *aff'd per curiam by an equally divided court*, 471 U.S. 81 (1985) (deeming market-participant exception inapplicable to the State as lessor, where "practical considerations" rendered lessees unable to "shop around" so that State "has complete monopoly over the sites used by the oil companies" and "companies have no choice"); *Shell Oil Co. v. City of Santa Monica*, 830 F.2d 1052, 1057 (9th Cir. 1987) (reiterating monopoly exception to market-participant exemption while declining to apply that exception to an incomplete monopoly). See generally Polelle, *supra* note 59, at 675-76 ("Several lower courts have concluded that, to the extent a governmental unit engages in monopolistic activities that would run afoul of the antitrust laws if committed by private businesses, the market participation doctrine should not apply."); Williams, *supra* note 5, at 506-511 (advocating monopoly limitation to the market-participant exception). *But see* *Four T's v. Little Rock Mun. Airport Comm'n*, 108 F.3d 909 (8th Cir. 1997) (applying market-participant exception to state concession fees charged to rental car companies despite Commission's monopoly on those spaces); *Chance Mgmt. v. South Dakota*, 97 F.3d 1107, 1114 (8th Cir. 1996) (upholding South Dakota law permitting licenses for video lottery to be granted only to corporations that have a majority of shares held by South Dakota residents by applying market-participant exception and rejecting argument that exception does not apply where state has monopoly); *Lefrancois v. Rhode Island*, 669 F. Supp. 1204, 1212 (D.R.I. 1987) ("While Rhode Island admittedly holds a monopoly in landfill services, I can see no distinction between this monopoly and the monopoly the State and its municipalities hold in education services, or in police and fire protection."); *but cf.* Barbara J. Redman, *The Market Regulator-Market Participant Distinction and Supreme Court Vigilance over Discriminatory State Programs: Does Economic Theory Justify the Judicial Effort?*, 25 AM. BUS. L.J. 585, 590 (1988) ("In an economic sense, a monopolist may be regarded as a participant in the market it monopolizes....").

<sup>97</sup> See *Reeves, Inc. v. Stake*, 447 U.S. 429, 437 (1980) (noting that South Dakota had not "restricted the ability of private firms or sister States to set up [cement] plants within its borders").

<sup>98</sup> See *supra* note 24 and accompanying text.

<sup>99</sup> A monopoly is most typically defined as "[c]ontrol or advantage obtained by one supplier or producer over the commercial market within a given region." BLACK'S LAW DICTIONARY 1028 (8th ed. 2004). In *United Haulers*, the flow control ordinance forced citizens to have their trash sent off for handling to one government-owned facility. See *United Haulers*, 127 S. Ct. at 1786. The municipality, through the forced-use law,

to this reasoning, that there can be no monopoly exception to the market-participant rule because the essential holding of *United Haulers* is to uphold a government monopoly in the marketplace.

On another view, Justice Souter's approach would not alter the operation of any monopoly exception in the sort of case typified by the no-other-cement-seller hypothetical variation on *Reeves*. In that hypothetical, the difficulty is that the would-be out-of-state buyer is entirely shut out from securing a needed product because of the state seller's monopoly position. In *United Haulers*, however, the government's exertion of monopoly power did not affect out-of-state buyers at all. Instead, it imposed a burden on in-state buyers of waste services. Thus (so the argument goes) the two cases differ in terms of both economic structure and political-process realities.

In the end, it is not clear whether endorsement of Justice Souter's broadened conception of the market-participant doctrine would bring with it the demise of any now-existing monopoly-based limit on that doctrine's operation. The key point, however, is crystal clear. Justice Souter's new rhetoric would create a new and inviting opening for courts to abandon any such monopoly exception.

(c) *Part IIIB and the State-Self-Promotion Principle.* The Court in *United Haulers* and in Part IIIA of *Davis* established a new state-self-promotion limit on the Commerce Clause antidiscrimination principle.<sup>100</sup> A major question presented by *Davis* concerns how a judicial embrace of the reasoning of Part IIIB would interact with the state-self-promotion limit and affect its reach. The most probable answer to this question is that the market-participant exception as reformulated in Part IIIB would essentially cover all the ground now occupied by the state-self-promotion principle and cover much additional ground as well. In particular, an endorsement of Justice Souter's Part IIIB analysis would, as a practical matter, untether the *United Haulers* doctrine from any limit based on either (1) the nontraditional character of the government's action and (2) the continuing applicability of *Pike* balancing analysis. These refinements would have the real-world effect of significantly expanding the new dormant Commerce Clause immunity espoused in *United Haulers*.

(i) *Nontraditional State Activities.* One complexity raised by Justice Souter's market-participant analysis concerns judicial treatment of forced-use rules – or any sort of regulatory or taxing measures – that are connected up with state market participation of a nontraditional sort.

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became the single supplier of waste processing in that region and therefore had a monopoly on waste processing.

<sup>100</sup> See *supra* notes 7, 10-11, 18 and accompanying text.

Consider *Reeves*.<sup>101</sup> What if, instead of simply preferring South Dakotans in selling cement from its state-owned plant, South Dakota had required all in-state purchasers to buy cement from it? Under the reasoning of *United Haulers* and Part IIIA of *Davis* standing alone, it is far from clear that this forced-use rule would pass constitutional muster. When the Court upheld the waste-transfer-station forced-use rule in *United Haulers*, and again applied *United Haulers* in Part IIIA of *Davis*, it went out of its way to emphasize that it was dealing with something that was “both typically and traditionally a function of local government.”<sup>102</sup> Because cement selling (to say the least) does not qualify as a traditional state undertaking, a legal challenge to any forced-use rule applied to the South Dakota plant would present a difficult question under the principle set forth in *United Haulers*.<sup>103</sup>

Adoption of Part IIIB of Justice Souter’s opinion, however, would transform this nettlesome question into a no-brainer. This is the case because (1) Justice Souter indicated in Part IIIB that the market-participant doctrine, if properly applied, would shelter the forced-use rule at issue in *United Haulers*;<sup>104</sup> and (2) under settled doctrine, the market-participant doctrine operates whether the state is engaged in a traditional public activity (such as selling waste disposal services) or a traditionally non-public activity (such as selling cement).<sup>105</sup> To put the same point differently, the only way to distinguish the forced-use rule in *United Haulers* from the forced-use rule in our hypothetical state-cement-sale case would be to say that the cement case involves nontraditional, rather than traditional, government activity. If we follow Part IIIB in recasting *United Haulers* as a market-participant case, however, that distinction could not take hold because the market-participant exception applies equally to traditional and nontraditional undertakings. To be sure, one could argue that it should matter for market-participant purposes whether the state’s marketplace activity is traditional in nature. But that is precisely the argument – made in

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<sup>101</sup> See *supra* notes 32-34 and accompanying text.

<sup>102</sup> *Dep’t of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1801 (2008); see *United Haulers*, 127 S. Ct. at 1796.

<sup>103</sup> See Coenen, *supra* note 7, at \_\_\_ (considering this question and whether, in particular, Court will ultimately embrace a traditional-activity/nontraditional-activity distinction in applying the state-self-promotion doctrine).

<sup>104</sup> See *Davis*, 128 S. Ct. at 1811 (indicating that the forced-use rule fell under the “broader rubric of the market-participant doctrine”).

<sup>105</sup> See *infra* notes 107-08 and accompanying text.

powerful terms by Justice Powell<sup>106</sup> – that a majority of the Court rejected in *Reeves* itself.<sup>107</sup>

The bottom line is this: At least as of today, the rule of *United Haulers* goes no further than to shelter challenged regulatory measures when they are tied to traditional forms of state action in transferring valuable property or services. The market-participant doctrine, in contrast, applies without regard to the traditional or nontraditional nature of the state’s activities.<sup>108</sup> Part IIIB of the *Davis* opinion thus invites a significant *de facto* expansion of the *United Haulers* principle. By dressing that principle in new market-participant attire, Justice Souter would strip away any nontraditional-activity limitation on its operation.<sup>109</sup>

(ii) *Pike Balancing Analysis*. An embrace of Part IIIB of Justice Souter’s opinion in *Davis* would have a second major impact on the state-self-promotion limitation formulated in *United Haulers*. Why? Because it would remove any need in *United-Haulers*-type cases for courts to engage in the sort of dormant Commerce Clause interest-balancing analysis undertaken in *United Haulers* itself.

To understand this point, it is necessary to recognize that the Court’s work in *United Haulers* proceeded in two steps. First, the Court

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<sup>106</sup> *Reeves, Inc. v. Stake*, 447 U.S. 429, 450 (1980) (arguing that the market-participant rule should hinge on “the nature of the governmental activity involved” and that the exception should only apply when “a public enterprise undertakes an ‘integral operatio[n] in areas of traditional government functions’” (alteration in original) (citation omitted)).

<sup>107</sup> *See id.* at 438 n.10 (“Even where ‘integral operations’ are not implicated, States may fairly claim some measure of a sovereign interest in retaining freedom to decide how, with whom, and for whose benefit to deal.”). *Accord*, David S. Bogen, *The Market Participant Doctrine and the Clear Statement Rule*, 29 SEATTLE U. L. REV. 543, 556-557 (2006) (stating that the *Reeves* Court expressly “rejected the traditional function theory as the basis for the market participant doctrine by applying the market participant doctrine to cement production, which is not a traditional function of government”); Dan T. Coenen, *The Impact of the Garcia Decision on the Market-Participant Exception to the Dormant Commerce Clause*, 1995 U. ILL. L. REV. 727, 740-742 (asserting that *Alexandria Scrap* did not distinguish between “‘governmental’ and ‘proprietary’ activities” but rather distinguished between states that acted as “market-participants” and states that acted as “market regulators”); David Pomper, Comment, *Recycling Philadelphia v. New Jersey: the Dormant Commerce Clause, Postindustrial ‘Natural’ Resources, and the Solid Waste Crisis*, 137 U. PA. L. REV. 1309, 1321 (1989) (arguing that the market-participant exception should apply whether the state is functioning in its traditional capacity or not).

<sup>108</sup> *See supra* note 107 and accompanying text.

<sup>109</sup> *See generally* Edward A. Zelinsky, *The False Modesty of Department of Revenue v. Davis: Disrupting the Dormant Commerce Clause Through the Traditional Public Function Doctrine* (manuscript on file with author) (broadly exploring implications of Court’s advancing of the traditional-activity/nontraditional-activity distinction in *Davis*).

found that the state-self-promoting forced-use rule did not embody the sort of “discrimination” that triggers exacting scrutiny under the dormant Commerce Clause principle.<sup>110</sup> Second, the Court considered whether that forced-use rule nonetheless ran afoul of the more tolerant style of constitutional analysis encapsulated in the balancing formula of *Pike v. Bruce Church, Inc.*<sup>111</sup> Under the *Pike* test, the court will invalidate even a nondiscriminatory statute if “the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits.”<sup>112</sup> In the end, the Court in *United Haulers* found no problem with the challenged flow control law under the *Pike* standard.<sup>113</sup> The pivotal point for present purposes, however, is that the Court signaled by way of this two-step dance that regulations exempted from antidiscrimination analysis under the state-self-promotion principle would nonetheless remain subject to *Pike*-balancing review and subject to invalidation under it in a proper case.

This elaboration of *United Haulers* highlights a critical difference between Part IIIA and Part IIIB of the *Davis* opinion. Given the fact that a majority of the Court joined only Part IIIA, Justice Souter concluded in *Davis* that there was good reason to consider whether Kentucky’s tax break was unconstitutional under *Pike* analysis – and that is just what he did in a separate section of the opinion labeled Part IV.<sup>114</sup> There can be little doubt, however, that a majority’s endorsement of Part IIIB would have swept away any need to engage in a *Pike*-balancing inquiry. Justice Souter himself made the key point when he wrote: “*United Haulers* included a *Pike* analysis ... but our cases

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<sup>110</sup> *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1797 (2007) (“[T]he Counties’ flow control ordinances, which treat in-state private business interests exactly the same as out-of-state ones, do not ‘discriminate against interstate commerce’ for purposes of the dormant Commerce Clause.”).

<sup>111</sup> 397 U.S. 137 (1970). The test is reserved for laws “directed to legitimate local concerns, with effects upon interstate commerce that are only incidental.” *Philadelphia v. New Jersey*, 437 U.S. 617 (1978).

<sup>112</sup> *Pike*, 397 U.S. at 142.

<sup>113</sup> *United Haulers*, 137 S. Ct. at 1798.

<sup>114</sup> *Dep’t of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1817 (2008). In fact, there was a strong reason not to apply *Pike* balancing in *Davis* because that case involved a challenged tax law, rather than a challenged regulation, and the Court has historically not subjected state tax laws to *Pike*-balancing analysis. *See, e.g., Coenen*, supra note 7, at \_\_\_. Justice Souter noted, however, that all parties in *Davis* had seen fit to evaluate the Kentucky tax rule under *Pike*, and for this reason he proceeded to do so as well. The Court’s application of *Pike* analysis even to the tax law at issue in *Davis* reinforces the key point suggested here because it highlights the importance of *Pike* analysis in applying the state-self-promotion rule – in striking contrast to its irrelevance in the market participation context.

applying the market participant rule have not.”<sup>115</sup> This statement is on the mark because the Court has never even considered applying *Pike* analysis in market-participant cases. It has proceeded in this way based on simple logic: When a state acts as a market participant, “no conflict between state *regulation* and federal regulatory authority can arise”<sup>116</sup> because the conduct of the state does “not involve” regulatory action at all.<sup>117</sup> In *United Haulers*, however, the Court took an entirely different view of the state’s forced-use rule. Precisely because it saw that rule as regulatory in nature, it refused to exempt the rule altogether from dormant Commerce Clause scrutiny. Instead, the Court did subject the challenged rule to review, but only to the ratcheted-down style of review reflected in the *Pike* methodology.

What all of this means is that a judicial embrace of Part IIIB would sharply alter preexisting law because it would move cases such as *United Haulers* and *Davis* into the market-participant camp. And because market-participant cases do not trigger *Pike* review, the potential for *Pike*-based invalidation that now exists under the more focused state-self-promotion rule would vanish from the scene. As a practical matter, the ability of courts to apply *Pike* balancing review in state-self-promotion cases rendered the inroad made by *United Haulers* on the dormant Commerce Clause restraint – although significant – far more limited than it might have been. Endorsement of Part IIIB of Justice Souter’s opinion would remove that limitation and thus bring about a far greater contraction of dormant Commerce Clause protections than was worked in *United Haulers* itself.

### III. DAVIS AND DOCTRINAL UNCERTAINTY

As we have seen, Justice Souter’s new rhetoric of market participation raises the prospect of a large-scale dilution of the dormant Commerce Clause principle.<sup>118</sup> Or does it? Justice Souter might

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<sup>115</sup> *Davis*, 127 S. Ct. at 1801.

<sup>116</sup> *Reeves, Inc. v. Stake*, 447 U.S. 429, 435 (1980) (quoting *Alexandria Scrap*, 526 U.S. at 805); see also *New Energy Co. v. Limbach*, 486 U.S. 269, 277 (1988) (noting that only when a state acts in its “distinct governmental capacity” is dormant Commerce Clause applicable).

<sup>117</sup> *United Bldg. & Const. Trades Council v. Mayor of Camden*, 465 U.S. 208, 220 (1984).

<sup>118</sup> See *supra* notes 66-69 and accompanying text (discussing effect of Justice Souter’s analysis on tax cases), notes 83-87 and accompanying text (discussing effect on the Court’s opinion in *Baldwin*), notes 91-93 and accompanying text (discussing effect on downstream restraint cases such as *South-Central Timber*), notes 96-99 and accompanying text (discussing effect on monopoly exception), notes 106-08 and

observe that such a claim is wildly exaggerated. Part IIIB, after all, does not purport to overrule a single dormant Commerce Clause precedent. And even Part IIIB's treatment of *United Haulers* might be viewed as not putting that case in the market-participant camp; perhaps, for example, the plurality mentioned *United Haulers* in Part IIIB only to show that the Court had previously (albeit outside the market-participant context) examined a regulation's linkage to state market participation in applying the dormant Commerce Clause, so that examining that same linkage in applying the market-participant doctrine in *Davis* should come as no surprise.

Whatever one might say about these matters, one thing is plain: If Part IIIB is embraced as governing law, it will raise a host of new questions about the market-participant rule. For example: Are all forms of state regulation (including outright embargoes, tariffs, and flat bans on importation) potentially sheltered from invalidation by the market-participant doctrine if they are linked to some identifiable state market activity?<sup>119</sup> Whatever the form of state activity, what degree of interconnection between a challenged regulation (including by way of taxation) and permitted state market participation will suffice to trigger Justice Souter's linkage principle? Must the linkage be such that non-state transactions are entirely (or essentially or largely or substantially) unaffected? Is the nature of the linkage more important than its spillover effects on private transactions? And, however linkage is gauged, will higher or lower levels of linkage be tolerated depending on the type, scope, and practical effect of the particular regulation (and market participation) at issue? These questions serve to highlight the lingering amorphousness of Part IIIB.

Two other features of Justice Souter's market-participant analysis contribute to the swirl of uncertainty. Those features concern (a) the analytical pathway that Justice Souter chose not to take in Part IIIB and (b) Justice Stevens's decision to join Part IIIB while also writing separately about his own perspective on the market-participant doctrine.

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accompanying text (discussing effect on distinction between traditional and nontraditional state activity), and notes 111-13 and accompanying text (discussing effect on use of *Pike* balancing in state-self-promotion cases).

<sup>119</sup> Justice Souter's treatment of *United Haulers* itself indicates that some local-processing requirements would be sustainable on market-participant grounds. See *Davis*, 128 S. Ct. at 1811. So why would the immunity not extend to other forms of state action historically viewed as protectionist, such as heavy burdens or outright bans on importation from outside the state or embargoes imposed to keep valuable resources from moving outside the state? See *Coenen*, *supra* note 7, at \_\_\_ (explaining why *United Haulers* in effect involved an import ban).

A. *The Road Not Taken*

One troublesome aspect of Part IIIB comes into view when one asks a simple question: Could Justice Souter have put forward a different and more stable analysis to uphold the Kentucky program under the market-participant doctrine? As it turns out, he could have crafted a much narrower market-participant rationale, and the fact that he eschewed this route heightens the confusion left in the wake of *Davis*.

A less ambitious Part IIIB would have begun with language along the following lines: “We held in Part IIIA that Kentucky’s tax-based favoritism of bonds issued by Kentucky and its instrumentalities is shielded from antidiscrimination-based attack by the state-self-promotion exception first recognized in the *United Haulers* case. We now further hold that, even if *United Haulers* had gone the other way, Kentucky’s program would find shelter in the market-participant exception to the dormant Commerce Clause.” This opening (unlike the actual opening of Part IIIB) would have made clear why an alternative analysis under the market-participant doctrine was worth pursuing; would have avoided the adventurous effort to shoehorn *United Haulers* into the market-participant category;<sup>120</sup> and would have pointed the way to a more satisfactory analytical route than the one that Justice Souter (having started off on the wrong foot) actually traversed.

In the next step of a more satisfying analysis, Justice Souter would have acknowledged that *United Haulers* presented a case of market regulation, rather than market participation, because it involved an unmistakably coercive government directive.<sup>121</sup> He then would have observed that the program in *Davis*, in telling contrast, did not coerce anyone to do anything, because no one needed to buy bonds. Having set the stage this way, he could have gone on to explain that: (1) under ordinary circumstances, tariffs and other forms of discriminatory tax laws are rightly viewed as regulatory in nature;<sup>122</sup> (2) the discriminatory tax at issue in *Davis* nonetheless differed from the discriminatory taxes invalidated in past cases because it favored in-state commerce only with

<sup>120</sup> See *supra* note 24 and accompanying text.

<sup>121</sup> See *supra* note 35 and accompanying text.

<sup>122</sup> This is the case in part because they are quasi-coercive in that those who do engage in the taxed activity must pay the tax, in part because they involve an activity that only governments can undertake, and in part because practical and historical understandings recognize these programs’ inevitable regulatory effects. See Coenen, *supra* note 5, at 430-35; Galle & Yale, *supra* note 18, at 113-46 (observing that “[t]axation is a ‘regulatory’ function”).

the state itself rather than with private entities;<sup>123</sup> and (3) that, for this reason, *Davis* in fact posed a novel (and very narrow) market-participant question. That narrow question was whether tax relief afforded by a state to make the state's own bonds more attractive to some buyers is more properly characterized as *regulation of the bond market* or as a *component part of the bond product* sold by the state itself.

Having framed the question this way, Justice Souter could have answered it by characterizing the tax-break as a component part of the bond product, rather than as a form of state regulation. (The tax break, after all, was tied directly and only to the acquisition of bonds created by the state itself; it immediately shaped the value of those bonds; it generated revenues for use only by the state itself; it operated only for the duration of the bonds' existence; and it created costs to the very same public fisc out of which bond proceeds were solely funded.)<sup>124</sup> To be sure, this characterization would have invited criticism on the ground that it afforded market-participant protection, for the first time ever, to a state taxing program.<sup>125</sup> Justice Souter, however, might have parried that thrust with an observation that went like this: "In the distinctive context of state-supplied products, it makes little sense to flatly reject the idea that a tax break can never be a protected element of market participation. By way of example, the Court in *Reeves* upheld South Dakota's exclusion of all out-of-state residents from the purchase of state-made cement. To us it logically follows, on the ground that the greater power must include the lesser, that South Dakota could have permitted out-of-state residents to buy cement while imposing a tax on such sales from which in-state buyers were exempt. For this reason, we reject the idea that the market-participant exception can never shelter discriminatory tax laws from constitutional challenge, even while accepting the idea that the market-participant doctrine will apply in the tax context only under unusual conditions. The key in our *Reeves* hypothetical, just like here, is that the underlying product with which the state tax break is associated is one that is created by the state, marketed by the state, and used by the state both to benefit its citizens and to fund its own operations."

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<sup>123</sup> In fact, Justice Souter made this point in so many words. See *Davis*, 128 S. Ct. at 1809 (aligning *Davis* with *United Haulers*, in that state action that benefits the state itself is different from "laws favoring particular private businesses over their competitors").

<sup>124</sup> See Brief for Petitioners, at 3-8, *Dep't of Revenue of Ky. v. Davis*, 128 S. Ct. 1801 (2008) (No. 06-666).

<sup>125</sup> See *supra* note 73 and accompanying text.

Perhaps Justice Souter meant for Part IIIB to say nothing of consequence that went beyond the contents of the three preceding paragraphs. In fact, however, he did say more. He recast *United Haulers* as a market-participant case.<sup>126</sup> He broadly reframed the underlying rationales of *White* and *Alexandria Scrap*.<sup>127</sup> He endorsed the innovative notion that activity properly characterized as market regulation may be sheltered under the market-participant rubric.<sup>128</sup> He set forth a new “part and parcel” test without identifying any limiting principles to guide its application.<sup>129</sup> And he left open the possibility that his version of the market-participant exception would lead to judicial toleration of forms of state regulation that go well beyond simply defining the terms of a business arrangement made with the state itself.<sup>130</sup> This is not to say that the more narrow and structured market-participant analysis advanced in the preceding paragraphs is so compelling as to withstand any and all criticism.<sup>131</sup> It is to say, however, that the analysis actually embodied in Part IIIB carries with it many more uncertainties than this posited alternative analysis would have engendered.

#### B. *The Stevens Wild Card*

A final complexity presented by Part IIIB is raised by the curious fact that Justice Stevens joined it in full while also writing his own concurring opinion.<sup>132</sup> Justice Stevens wrote separately to explain why he “would join the Court’s opinion even if [*Reeves* and *United Haulers*] had been decided differently” because he had in fact dissented

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<sup>126</sup> See *supra* note 24 and accompanying text.

<sup>127</sup> See *supra* notes 38-43 and accompanying text, and notes 50-58 and accompanying text.

<sup>128</sup> See *supra* note 20 and accompanying text.

<sup>129</sup> See *supra* note 51 and accompanying text.

<sup>130</sup> See, e.g., *supra* notes 84-88 and accompanying text (discussing the *Baldwin* case).

<sup>131</sup> For example, the challengers of the state program of *Davis* argued that taxation, by definition, cannot qualify as market participation because private traders cannot impose taxes and one element of the Court’s market-participant logic is that states should share the rights of “the trader or manufacturer, engaged in an entirely private business.” *Reeves, Inc. v. Stake*, 447 U.S. 429, 438 (1980) (quoting *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919)); see Julander, *supra* note 5, at 552 (noting that market-participant exception developed in light of “the long recognized right of private traders to choose their own trading partners”); *id.* at 554 (noting that a “tax credit” is not an “activity of a private purchaser”).

<sup>132</sup> See *Dep’t of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1804 (2008).

in each of those cases.<sup>133</sup> So what does Justice Stevens’s opinion tell us about Part IIIB?

To begin with, Justice Stevens did not abandon his earlier positions by signing onto either the result reached in *United Haulers* or the *Reeves*-based version of the market-participant doctrine. Rather, he expressed continued adherence to his minority position in both *Reeves* and *United Haulers*, reiterating his view that “when a ‘State enters the private market and operates a commercial enterprise for the advantage of its private citizens, it may not evade the constitutional policy against economic Balkanization.’”<sup>134</sup> That principle, he explained, did not apply in *Davis* because Kentucky had not undertaken “to operat[e] a commercial enterprise”; rather it was “merely borrow[ing] money ‘to pay for spending on transportation, public safety, education, utilities, and environmental protection.’”<sup>135</sup> In these circumstances, Justice Stevens detected no dormant Commerce Clause problem because a “State’s reliance on ‘general taxes or municipal bonds’ to finance public projects does not merit the same Commerce Clause scrutiny as ‘operating a fee-for-service business enterprise in an area where there is an established interstate market.’”<sup>136</sup> According to Justice Stevens, “state action that motivates a State’s taxpayers to lend money to the State” – whether in the form of state tax breaks or the offering of “[f]ree tickets to the Kentucky Derby” – “is simply not the sort of ‘burden’ on interstate commerce that is implicated by our dormant Commerce Clause jurisprudence.”<sup>137</sup>

One is left in a head-scratching state by Justice Stevens’s analysis. How could he join Part IIIA of the Souter opinion – which is founded squarely on a straightforward application of *United Haulers* – at the very time he reiterated his view that *United Haulers* was an erroneous decision? How could he join Part IIIB, which seemed to endorse just the sort of expansive vision of the market-participant doctrine from which Justice Stevens took pains to distance himself in his separate concurrence? And how could Justice Stevens characterize *Davis* as a case that did not involve a state’s “operating a fee-for-service business enterprise in an area where there is an established interstate market”?<sup>138</sup> In fact, there exists an “established interstate market” in

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<sup>133</sup> *Id.* at 1819 (Stevens, J. concurring).

<sup>134</sup> *Id.* at 1820.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.* (quoting *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1794 (2007) (Alito, J., dissenting)).

<sup>137</sup> *Id.* at 1820-21.

<sup>138</sup> *Id.* at 1820.

debt instruments, and selling such instruments for cash is not hard to view as “operating a fee-for-service business enterprise” – at least once one makes the easy move of viewing as a valuable “service” the transformation of X amount of cash into an X+Y stream of payments made over time.<sup>139</sup>

One possibility is that Justice Stevens viewed Justice Souter’s opinion as focusing primarily on the states’ historic use of bonded indebtedness,<sup>140</sup> their issuance of bonds “to finance public projects,”<sup>141</sup> and the inevitability that states had to raise money in some way to engage in their core activities.<sup>142</sup> Put another way, Justice Stevens may have signed onto Part IIIB of Justice Souter’s opinion only on the understanding that it endorsed (or at least invited) a reframing of the market-participant exception along the lines advanced 30 years earlier in the *Reeves* dissent – that is, as a doctrine that can operate only when the state undertakes “traditional” government activities.<sup>143</sup>

This possibility lends another – and a distinctively sticky – layer of uncertainty to the plurality’s application of the market-participant exception in *Davis*. Up until now, our parsing of Part IIIB has suggested that it envisions a controversial expansion of the market-participant exception and a concomitant narrowing of dormant Commerce Clause restraints.<sup>144</sup> In striking contrast, the reading extrapolated here from Justice Stevens’ curious joining of Part IIIB would move the law in exactly the opposite direction. By tying the market-participant exception to traditional state conduct, this alternate reading would narrow that exception, including by overturning the Court’s seminal market-participant decision in the *Reeves* case itself.

Is such a translation of Part IIIB possible? It involves a stretch, in part because Justice Souter laid out the holding of *Reeves*, without ever questioning its authority, both in Part II of the opinion<sup>145</sup> and in a textual footnote in Part IIIB.<sup>146</sup> On the other hand, Justice Souter’s actual market-participant analysis in Part IIIB puts primary emphasis on

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<sup>139</sup> Few would disagree with the proposition, for example, that banks provide a “service” for a “fee” when they sell certificates of deposit redeemable in one year at an amount that reflects both principal and interest. Justice Stevens never explained why state sales of functionally identical debt instruments do not likewise involve a “fee-for-service business enterprise.”

<sup>140</sup> See *Davis*, 128 S. Ct. at 1806-08.

<sup>141</sup> *Id.* at 1820 (Stevens, J. concurring).

<sup>142</sup> *Id.* at 1811 (majority opinion).

<sup>143</sup> See *supra* notes 106-07 and accompanying text.

<sup>144</sup> See *supra* note 118 and accompanying text.

<sup>145</sup> *Davis*, 128 S. Ct. at 1809.

<sup>146</sup> *Id.* at 1814 n.16.

*United Haulers*, *Alexandria Scrap*, and *White* – all of which might well be seen as “traditional function” cases.<sup>147</sup> No less important: (1) Justice Souter’s opinion emphasized and reemphasized that states historically have issued bonds for public purposes and favored their own taxpayers in doing so;<sup>148</sup> (2) although this theme is not a focal point of Part IIIB, it dominates not only Part IIIA but also the opening and closing segments of Justice Souter’s opinion;<sup>149</sup> and (3) in particular, the ringing conclusion of that opinion excoriates the dissenters’ approach precisely because (a) they embrace “the adventurism of overturning a traditional local taxing practice;”<sup>150</sup> (b) they “would upset ... settled expectations ... based on the experience of nearly a century;”<sup>151</sup> and (c) they ignore “the long settled habits of the community,” which (according to no less an icon than Justice Holmes) should “play a part” in resolving constitutional disputes.<sup>152</sup> Perhaps, in the view of Justice Stevens, these passages gave rise to an analytical theme that both overlaid and logically limited the market-participant analysis put forward by Justice Souter in Part IIIB.

Might a future Court, if it were to embrace Justice Souter’s opinion in toto, actually find in it the seeds of the destruction of *Reeves*? The possibility that it could do so underscores the key point offered here. If Justice Souter’s opinion in *Davis* brings sweeping new uncertainties to the Court’s market-participant jurisprudence – as it surely does – Justice Stevens’s joining of that opinion brings even more, when viewed in the light of his separate concurrence.

## CONCLUSION

“There’s something happening here, but what it is ain’t exactly clear.”<sup>153</sup> These lyrics were not written by Stephen Stills to deal with

<sup>147</sup> See *Reeves, Inc. v. Stake*, 447 U.S. 429, 451 (1980) (Powell, J., dissenting) (highlighting that, unlike the state’s actions in *Reeves*, the state’s actions in *Alexandria Scrap* embodied a traditional government function); *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1796 (2007) (stating that the waste disposal involved in that case was “both typically and traditionally” a state function).

<sup>148</sup> See *Davis*, 128 S. Ct. at 1806; *id.* at 1810; *id.* at 1819.

<sup>149</sup> See *id.* at 1806 (discussing the history of differential tax breaks on municipal bonds in opening the opinion); *id.* at 1810 (discussing the same throughout part IIIA); *id.* at 1819 (discussing the same in the opinion’s closing section).

<sup>150</sup> *Id.* at 1819.

<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

<sup>153</sup> STEPHEN STILLS, *For What It’s Worth*, on BUFFALO SPRINGFIELD (Atco 1967). See also BOB DYLAN, *Ballad of a Thin Man*, on HIGHWAY 61 REVISITED (Columbia 1965) (“something is happening here/ [b]ut you don’t know what it is, do you Mr. Jones?”);

dormant Commerce Clause law, but they might aptly be sung – indeed, sung with intensity – about Justice Souter’s market-participant analysis in the *Davis* case. The cryptic character and indeterminate implications of Part IIIB surely contributed to its most salient feature – namely, its failure to garner the support of a majority of the Court. The six Justices who declined to join Part IIIB acted wisely in refusing to embrace Justice Souter’s newfangled treatment of the market-participant doctrine. In the future, they should go even further by rejecting that treatment in no uncertain terms.

As this essay demonstrates, that course of action is advisable because endorsement of Justice Souter’s analysis would (1) radically reformulate the basic rhetoric of the market-participant exception; (2) invite major changes in doctrine, including by way of an ill-advised narrowing of salutary dormant Commerce Clause restraints; and (3) inject profound uncertainties into this already complex field of law. The Supreme Court has rightly declared that the market-participant doctrine, in its present form, reflects both “good sense and sound law.”<sup>154</sup> In the end, the Court should eschew Justice Souter’s Part IIIB analysis because its revisionist approach to that doctrine is undeserving of the same benign description.

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MARVIN GAYE, *What’s Going On*, on WHAT’S GOING ON (Tamla 1971) (“What’s going on? What’s going on? Oh, what’s going on?”).

<sup>154</sup> *Reeves*, 447 U.S. at 436.