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Differential Taxation of Interest Derived from Out-of-State Municipal Bonds Does Not Violate the Dormant Commerce Clause:

*Department of Revenue v. Davis*

**CONSTITUTIONAL LAW — DORMANT COMMERCE CLAUSE — DIFFERENTIAL TAXATION OF MUNICIPAL BONDS** — The United States Supreme Court held that the Commonwealth of Kentucky’s income tax scheme, which differentially taxed interest derived from bonds issued by the Commonwealth from bonds issued by other states, did not offend Dormant Commerce Clause principles and, thus, was constitutional.


The Commonwealth of Kentucky, like most states, enacted an income tax scheme exempting from taxation interest income derived from municipal bonds\(^1\) issued by the Commonwealth or its subdivisions.\(^2\) It did not, however, extend this exemption to interest income received from municipal bonds issued by other states.\(^3\) Kentucky therefore taxed resident holders of out-of-state municipal bonds differently than resident holders of similar bonds issued by the Commonwealth.\(^4\) The professed purpose of this differential system was to make lower-interest bonds issued by Kentucky just as or more attractive than higher-interest bonds issued by other entities.\(^5\) Kentucky would then use the proceeds from these bonds

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1. A "municipal bond" is "[a] bond issued by a nonfederal government or governmental unit, such as a state bond to finance local improvements." *BLACK'S LAW DICTIONARY* 192 (8th ed. 2004).
3. *Davis*, 128 S. Ct. at 1805. The statute specifically includes “interest income derived from obligations of sister states and political subdivisions thereof” within the taxable net. § 141.010(10)(c).
4. *Davis*, 128 S. Ct. at 1805. Forty-one states have laws comparable to that of Kentucky. *Id.* at 1806-07; *see, e.g.,* 72 PA. STAT. § 9901(a) (West 2000 & Supp. 2008).
5. *Davis*, 128 S. Ct. at 1805-06.
to pay for various public works, such as transportation, education, and environmental protection.\textsuperscript{6}

George and Catherine Davis were two Kentucky residents who held out-of-state municipal bonds and paid Kentucky's income tax on the bonds' interest.\textsuperscript{7} They brought suit in state court alleging, \textit{inter alia}, that the Commonwealth's differential tax system violated the Dormant Commerce Clause of the United States Constitution.\textsuperscript{8} Specifically, they averred that the disparate taxation unconstitutionally discriminated against interstate commerce.\textsuperscript{9}

Relying on the "market-participant" exception to the Dormant Commerce Clause, the trial court granted the Commonwealth's motion for summary judgment.\textsuperscript{10} It determined that Kentucky was doing nothing more than participating in the bond market and thus was free to give deferential treatment to resident purchasers of its bonds.\textsuperscript{11}

The Court of Appeals of Kentucky unanimously reversed.\textsuperscript{12} Though it accepted that the Commonwealth was engaging in market participation by issuing bonds, it distinguished that activity from the act of taxation.\textsuperscript{13} According to Judge Minton, who wrote for the court, Kentucky was not participating in the market when it taxed the bonds but rather was engaging in regulatory activity.\textsuperscript{14} Because the tax regulation was truly at issue, and not the bond program, the court concluded that the tax was without an exception to save its facial discrimination.\textsuperscript{15}

\begin{footnotes}
6. \textit{Id.} at 1806. Over a six-year period, "Kentucky and its subdivisions issued $7.7 billion in long-term bonds to pay for spending on transportation, public safety, education, utilities, and environmental protection, among other things." \textit{Id.}

7. \textit{Id.} at 1807.

8. Davis v. Revenue Cabinet, No. 03CI03282, 2004 WL 5358776, at *2 (Ky. Cir. Ct. Aug. 20, 2004). The Commerce Clause vests in Congress the power "[t]o regulate Commerce... among the several states." \textit{U.S. Const. art I, § 8, cl. 3.}


10. \textit{Id.} at *4-5.

11. \textit{Id.} at *4. The trial court stated that "[t]his practice can be analogized to granting property tax breaks to various businesses, but not to others, in order to encourage businesses to remain in the state." \textit{Id.} (alteration in original) (citing Reeves v. Stake, 447 U.S. 429 (1980)).


13. \textit{Davis}, 197 S.W.3d at 564.

14. \textit{Id.}

15. \textit{Id.} The court noted:
Kentucky's bond taxation system is facially unconstitutional as it obviously affords more favorable taxation treatment to in-state bonds than it does to extraterritorially issued bonds. Thus, Kentucky's bond taxation system may be constitutionally valid only if it falls within an exception to the normal rule requiring laws that violate the Commerce Clause on their face be stricken.
\end{footnotes}
After the Supreme Court of Kentucky denied the Commonwealth's petition for review, the United States Supreme Court granted certiorari to consider whether Kentucky's tax scheme indeed violated the Dormant Commerce Clause. Justice Souter, writing for the majority, held that it did not. He began the constitutional analysis by observing that, when the Dormant Commerce Clause is invoked, the first question is whether the "law discriminates against interstate commerce." If it does, he wrote, then it is presumptively unconstitutional unless it promotes a legitimate function that cannot be appropriately supported by a non-discriminatory means. If it does not, he continued, then the law will stand unless its encumbrance on interstate commerce is patently disproportionate to the purported local benefits.

However, Justice Souter also explained that some cases present an exception to this usual protocol and require an analysis outside standard Dormant Commerce Clause scrutiny. According to the majority, of dispositive importance for this case was the "government function" exception enunciated in the opinion of United Haulers Ass'n v. Oneida-Herkimer Solid Waste Management Authority.

Justice Souter explained that, in United Haulers, the Court found constitutional significance between laws favoring in-state private entities over out-of-state private businesses and laws favoring State and local government over out-of-state competition.

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17. Id. Chief Justice Roberts and Justices Stevens, Breyer, Scalia and Ginsburg joined this portion of Justice Souter's opinion. Id. at 1804.
19. Davis, 128 S. Ct. at 1808. The Court observed: "A discriminatory law is 'virtually per se invalid.'" Id. (quoting Or. Waste Sys., 511 U.S. at 99). It "will survive only if it 'advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.'" Id. (quoting Or. Waste Sys., 511 U.S. at 101).
20. Davis, 128 S. Ct. at 1808. The Court explained: "Absent discrimination for the forbidden purpose, however, the law 'will be upheld unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits.'" Id. (alteration in original) (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)).
22. Id. at 1809-10 (citing United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 127 S. Ct. 1786 (2007)). Justice Souter stated: "In United Haulers, we explained that a government function is not susceptible to standard dormant Commerce Clause scrutiny . . . ." Id. at 1810 (alteration in original).
23. Id. at 1809.
He noted that the United Haulers Court believed that laws partial to states and localities—as opposed to purely private in-state entities—were not likely to be aimed at the economic protectionism that the Clause loathes.\textsuperscript{24} Rather, he explained, these laws were more likely to be focused on allowing the State to execute those duties traditionally reserved for state government, e.g., protecting the health, safety, and welfare of its citizens.\textsuperscript{25} Thus, Justice Souter recognized that the majority's conclusion in United Haulers was that laws serving these so-called "local government functions" were deserving of non-standard Dormant Commerce Clause examination.\textsuperscript{26}

Applying this rationale to the case \textit{sub judice},\textsuperscript{27} the majority found that Kentucky's differential tax scheme passed constitutional muster.\textsuperscript{28} The Court observed that the proceeds from municipal bonds were used to fund various public projects traditionally undertaken by the State, such as education and transportation.\textsuperscript{29} To that extent, the Court determined that the exemption favoring them was not aimed at the economic protectionism the Clause almost always forbids; rather, it was aimed at promoting archetypical local government functions.\textsuperscript{30}

With the public nature of the program supported by the tax scheme ascertained, the majority explained that it could now confront an essential component of the Dormant Commerce Clause inquiry: discrimination.\textsuperscript{31} Justice Souter observed that the Court was obliged to consider whether or not comparable entities existed in the case because any claim of discrimination presupposed an

\textsuperscript{24} \textit{Id.} As Justice Souter observed, "We found '[c]ompelling reasons' for 'treating [the ordinance] differently from laws favoring particular private business over their competitors.'" \textit{Id.} (alteration in original) (quoting United Haulers, 127 S. Ct. at 1795).

\textsuperscript{25} \textit{Davis,} 128 S. Ct. at 1809. The majority opined that: State and local governments that provide public goods and services on their own, unlike private businesses, are "vested with the responsibility of protecting the health, safety, and welfare of [their] citizens," and laws favoring such States and their subdivisions may "be directed toward any number of legitimate goals unrelated to protectionism." That was true in United Haulers, where the ordinance addressed waste disposal, "both typically and traditionally a local government function.

\textit{Id.} (quoting United Haulers, 127 S. Ct. at 1795-96).

\textsuperscript{26} \textit{Davis,} 128 S. Ct. at 1810.

\textsuperscript{27} In Latin, "\textit{sub judice}" translates as "under a judge." \textsc{Black's Law Dictionary} 1466 (8th ed. 2004). It means "[b]efore the court or judge for determination; at bar." \textit{Id.}

\textsuperscript{28} \textit{Davis,} 128 S. Ct. at 1810.

\textsuperscript{29} \textit{Id.}

\textsuperscript{30} \textit{Id.} at 1810.

\textsuperscript{31} \textit{Id.} at 1811.
evaluation of substantially similar forms.\textsuperscript{32} To that extent, the
majority noted that the Court’s prior decisions have held that
states should be treated as private parties with regard to the mu-
nicipal bonds that have left their boundaries.\textsuperscript{33} This being the
case, the majority found that Kentucky’s tax exemption benefitted
a public entity and treated all private bond issuers alike.\textsuperscript{34} As a
result, the Court held that no unconstitutional discrimination ex-
isted because Kentucky, as a public entity, was not comparable to
other states, which were private entities for purposes of municipal
bonds that leave their borders.\textsuperscript{35} Thus, the majority upheld the
tax scheme because it supported traditional government functions
without discriminating against comparable extraterritorial inter-
ests in favor of local private entities.\textsuperscript{36}

Despite garnering a majority of votes using the \textit{United Haulers}
analysis, Justice Souter, joined by a plurality of Justices, went
further and analyzed the case under another exception to stan-
dard Dormant Commerce Clause scrutiny: the “market-
participant” exception.\textsuperscript{37} Justice Souter noted that, in order to
qualify for this exception, a state must transcend the bounds of
normal regulation and actually partake in the market when favor-
ing its own citizens over citizens of other states.\textsuperscript{38} He then applied
this test to the instant case by addressing the Davises’ contention
that the tax at issue was the epitome of market regulation because
it imposed a higher tax on out-of-state municipal bonds than it did
on in-state municipal bonds.\textsuperscript{39} He observed that this argument
would be true if Kentucky acted in separate roles of issuing debt

\textsuperscript{32} \textit{Id.} Justice Souter stated: “this emphasis on the public character of the enterprise
supported by the tax preference is just a step in addressing a fundamental element of Dor-
mant Commerce Clause jurisprudence, the principle that ‘any notion of discrimination
assumes a comparison of substantially similar entities.’” \textit{Id.} (quoting \textit{United Haulers}, 127
S. Ct. at 1795).

\textsuperscript{33} \textit{Davis}, 128 S. Ct. at 1811 (citing Bonaparte v. Tax Court, 104 U.S. 592 (1882)).

\textsuperscript{34} \textit{Davis}, 128 S. Ct. at 1811.

\textsuperscript{35} \textit{Id.}

\textsuperscript{36} \textit{Id.}

\textsuperscript{37} \textit{Id.} (plurality opinion). Justices Stevens and Breyer joined this portion of Justice
Souter’s opinion. \textit{Id.} at 1804.

\textsuperscript{38} \textit{Id.} at 1809 (majority opinion). Indeed, the “market-participant” exception “covers
States that go beyond regulation and themselves ‘participat[e] in the market’ so as to exer-
cis[e] the right to favor [their] own citizens over others.” \textit{Id.} (alterations in original) (quot-
ing Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 810 (1976)). It “reflects a ‘basic dis-
tinction . . . between States as market participants and States as market regulators, . . .
[where] being no indication of a constitutional plan to limit the ability of the States them-
selves to operate freely in the free market.” \textit{Id.} (alterations in original) (quoting Reeves v.
Stake, 447 U.S. 429, 436-37 (1980)).

\textsuperscript{39} \textit{Davis}, 128 S. Ct. at 1811-12 (plurality opinion).
securities and fixing taxes, but Kentucky's tax scheme was rational only because it simultaneously participated in the bond market.\textsuperscript{40} Thus, the plurality stressed, the Court's "market-participant" cases stand for the very proposition that the Davises would have the Court ignore: that some form of regulation accompanying a government's commercial venture provides the exception to the rule.\textsuperscript{41} In this light, the plurality decided that the Commonwealth's tax scheme was constitutional because it was enacted with the purpose of benefitting the public through a vehicle in which the State participated: the municipal bond market.\textsuperscript{42}

Next, Justice Souter, again writing for a majority, examined the markets affected by the exemption to verify that no illicit discrimination was occurring.\textsuperscript{43} First, he looked at the broad market of all fixed-income securities, including bonds that were privately issued, and noted that Kentucky treated all bonds, other than the ones it issued, the same.\textsuperscript{44} Second, he explored the narrower market of municipal bonds themselves, commenting that, although the effects of the differential tax scheme were most obvious in this forum, it was truly notable that almost every state supported it.\textsuperscript{45} Lastly, he remarked that striking down the exemption could have potentially devastating effects on single-state municipal bond funds.\textsuperscript{46} In the aggregate, the majority found that these considerations denoted the essential nature of the tax scheme and confirmed that the Dormant Commerce Clause should not strike it down as discriminatory.\textsuperscript{47}

As a final matter, the majority addressed the application of the \textit{Pike}\textsuperscript{48} balancing test.\textsuperscript{49} After a cursory review of its specifications, the Court declined, for several reasons, to apply it to the facts of

\begin{itemize}
\item \textsuperscript{40} \textit{Id.} at 1812.
\item \textsuperscript{41} \textit{Id.} at 1813-14. The plurality stated:

In sum, our cases on market regulation without market participation prescribe standard dormant Commerce Clause analysis; our cases on market participation joined with regulation (the usual situation) prescribe exceptional treatment for this direct governmental activity in commercial markets for the public's benefit. \textit{Id.} at 1814 (footnote omitted).
\item \textsuperscript{42} \textit{Id.} at 1814.
\item \textsuperscript{43} \textit{Id.} at 1815 (majority opinion). Chief Justice Roberts and Justices Stevens, Breyer, Scalia, and Ginsburg join this portion of the Justice Souter's opinion. \textit{Id.} at 1804.
\item \textsuperscript{44} \textit{Davis}, 128 S. Ct. at 1815.
\item \textsuperscript{45} \textit{Id.} at 1815-16.
\item \textsuperscript{46} \textit{Id.} at 1816.
\item \textsuperscript{47} \textit{Id.} at 1817.
\item \textsuperscript{48} \textit{Pike}, 397 U.S. at 142. \textit{See supra} text accompanying note 20.
\item \textsuperscript{49} \textit{Davis}, 128 S. Ct. at 1817. Chief Justice Roberts and Justices Stevens, Breyer, and Ginsburg joined this portion of Justice Souter's opinion. \textit{Id.} at 1804.
\end{itemize}
the case. 50 First, the majority recognized that state courts did not make the inquiry and the Davises requested a remand so that one could be made. 51 Second, it noted that the application of Pike to cases of this kind was uncertain because, although United Haulers included the analysis, the "market-participant" cases did not. 52 Third, the Court noted that the Commonwealth did not argue the inapplicability of Pike. Finally, it voiced its concern over the judiciary's qualifications to engage in the acute level of analysis required for a law of this sort. 53 Thus, the Court reversed and remanded the case for further proceedings. 54

Justice Stevens concurred in order to explain why he joined Justice Souter's opinion in toto despite having dissented in both Reeves, Inc. v. Stake 55 and United Haulers. 56 According to Justice Stevens, both Reeves and United Haulers involved state participation in a private commercial market on which the state also imposed burdens. 57 For him, this situation was fundamentally different from the scenario where a state does not participate in any private commercial enterprise, such as when it borrows money in order to bankroll public works projects. 58 In this latter scenario, he reasoned that the State does not manage a commercial venture for purposes of the Dormant Commerce Clause. 59 Accordingly, he agreed that Kentucky's tax scheme withstood the constitutional attack in this case. 60

Chief Justice Roberts also concurred with Justice Souter, but only in part. 61 He did not believe that the "market-participant" analysis was necessary because the United Haulers rationale ade-

50. Id.
51. Id.
52. Id.
53. Id. at 1817-18. Justice Souter stated: The institutional difficulty is manifest in the very train of disadvantages that the Davises' counsel attributes to the current differential tax scheme . . . . Even if each of these drawbacks does to some degree eventuate from the system, it must be apparent to anyone that weighing or quantifying them for a cost-benefit analysis would be a very subtle exercise.
54. Davis, 128 S. Ct. at 1819.
55. 447 U.S. 429 (1980). Reeves was a "market participant" case. Id. See supra text accompanying note 37.
56. Davis, 128 S. Ct. at 1819 (Stevens, J., concurring).
57. Id. at 1819-20.
58. Id. at 1820.
59. Id.
60. Id.
61. Davis, 128 S. Ct. at 1821 (Roberts, C.J., concurring).
quately resolved the case. Justice Scalia similarly concurred, but he went further to disavow the *Pike* test discussed by the majority. According to him, it should be altogether abandoned.

Justice Thomas concurred as well, but only in the judgment. He iterated his desire for the Court to abandon its Dormant Commerce Clause jurisprudence because he believes that it lacks a constitutional foundation. Accordingly, he expressed the view that the tax scheme should be upheld because the Court lacked the power to overturn it.

Justice Kennedy, joined by Justice Alito, dissented. He criticized the majority's assertion that Kentucky's tax scheme was valid because it enabled the Commonwealth to discharge the traditional government functions of protecting the health, safety, and welfare of its people. According to him, the majority merely restated the principle that a state may act within its police powers. He contended that their argument was circular because whether or not something is within a state's police powers depends on whether or not the Constitution permits the act. Indeed, Justice Kennedy declared, the mere fact something is asserted to be within a state's police powers does not thereby exempt it from Commerce Clause scrutiny.

Viewed through this lens, Justice Kennedy concluded that the majority distorted the true issue in the case by focusing on bond issuance. In his opinion, the law truly in question—Kentucky's income tax exemption—was not directed toward protecting the health, safety, and welfare of the people. To the contrary, it af-

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62. Id.
63. Id. (Scalia, J., concurring).
64. Id.
65. Id. at 1821 (Thomas, J., concurring).
67. Id. at 1822.
68. Id. (Kennedy, J., dissenting).
69. Id. at 1824.
70. Id.
71. *Davis*, 128 S. Ct. at 1824 (Kennedy, J., dissenting). Justice Kennedy framed his position thusly:

The police power concept is simply a shorthand way of saying that a State is empowered to enact laws in the absence of constitutional constraints; but, of course, that only restates the question. That a law has the police power label—as all laws do—does not exempt it from Commerce Clause analysis.

Id.
72. Id. at 1824.
73. Id. at 1825.
74. Id.
fected only the holders of the bond, not the issuers. Justice Kennedy submitted that the customary rule that a state may not construct barricades to interstate commerce through the use of its taxing power should apply.

Accordingly, Justice Kennedy distinguished United Haulers from the instant case. He believed the majority ignored the fact that the ordinance in United Haulers applied even-handedly to both intrastate and interstate commerce because government had monopolized the refuse industry. Thus, he determined the ordinance in that case, unlike the expressed purpose of the law in the instant case, did not discriminate.

Additionally, Justice Kennedy distinguished United Haulers from the instant case. He believed the majority ignored the fact that the ordinance in United Haulers applied even-handedly to both intrastate and interstate commerce because government had monopolized the refuse industry. Thus, he determined the ordinance in that case, unlike the expressed purpose of the law in the instant case, did not discriminate.

Finally, Justice Kennedy briefly addressed the plurality’s “market-participant” analysis. He stated that taxation was in no way market participation, but the paradigmatic act of regulation. Moreover, he noted, even if it were participation, it would still fail because of its downstream regulation.

He concluded by stating that the Court’s concern over the potential disruption in the bond market if the law were to be overruled was legitimate. However, he noted that if the Court wished to uphold the law on that basis, it should make a sui generis exception.

Under the Dormant Commerce Clause, the Supreme Court invalidates state laws that, by their essential nature, regulate inter-

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75. Id.
76. Davis, 128 S. Ct. at 1825 (Kennedy, J., dissenting). Justice Kennedy first reviewed various cases involving taxation of securities to support this proposition. See Boston Stock Exch. v. State Tax Comm’n, 429 U.S. 318 (1977); Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984). From these cases he concluded that:

[l]he relevant inquiry is not the purpose of a bond but whether [a bond competes]. The majority cannot establish that, from an investor’s standpoint, Kentucky’s bonds do not compete with bonds from other state or municipal governments. Indeed, that competition is why the bonds need the advantages the exemptions give them.

Id. at 1825-26 (alteration in original). He then reviewed cases involving regulation of other commodities, see, e.g., Dean Milk Co. v. Madison, 340 U.S. 349 (1951) (involving discriminatory regulation of mill in violation of the Dormant Commerce Clause), to support the same conclusion. Id. at 1826-27.

77. Davis, 128 S. Ct. at 1827 (Kennedy, J., dissenting).
78. Id.
79. Id.
80. Id. at 1829.
81. Id.
82. Davis, 128 S. Ct. at 1830 (Kennedy, J., dissenting) (citing South-Central Timber Dev., Inc. v. Wunnick, 467 U.S. 82 (1984) (plurality opinion)).
83. Davis, 128 S. Ct. at 1830 (Kennedy, J., dissenting).
84. Id. Justice Alito added a brief statement after Justice Kennedy’s opinion agreeing with Justice Kennedy and stating his belief that “the Court’s established dormant Commerce Clause precedents should be followed . . . .” Id. (Alito, J., dissenting). In Latin, “sui generis” means “of its own kind.” BLACK’S LAW DICTIONARY 1475 (8th ed. 2004).
state commerce. However, one searches the text of the Constitution in vain when seeking to find the "Dormant" Commerce Clause because the Constitution itself does not contain such a provision. Rather, the Dormant Commerce Clause is a negative implication that the Supreme Court has drawn from the fact that the Constitution expressly grants Congress the power to regulate interstate commerce. The reasoning is that because Congress has the power to regulate, concomitant restrictions must be placed on the states from regulating. Thus, the Supreme Court strikes down those state laws that, by virtue of their protectionist aspects, regulate commerce among the several states.

The genesis of the Court's Dormant Commerce Clause jurisprudence can be traced back to Chief Justice Marshall and his opinion in Gibbons v. Ogden. However, the first authoritative ruling on the issue did not come until 1851 when the Taney Court decided Cooley v. Board of Wardens. In Cooley, the Court addressed the constitutionality of a Pennsylvania law that required ships entering or leaving Philadelphia harbor to employ a local pilot to guide them through the waters of the Delaware River. After noting that the regulation of pilots undoubtedly constituted a commercial regulation, the court then considered the central question of whether Congress's express authority to regulate interstate commerce per se deprived the States of any power to do so. In holding that it did not, the Court articulated a rule that focused primarily on the subject of the regulation. Indeed, the majority ob-

85. See KATHLEEN SULLIVAN & GERALD GUNTHER, CONSTITUTIONAL LAW 245 (15th ed. 2004).
86. See id.
87. See id. See also supra text accompanying note 8.
88. See id.
89. See id.
90. 22 U.S. (9 Wheat.) 1 (1824) (dictum) (opinion by Marshall, C.J.). Gibbons addressed a New York steamboat monopoly law that the Court ultimately invalidated under the Supremacy Clause. See U.S. CONST. art. VI, cl. 2. Gibbons, 22 U.S. (9 Wheat.) at 1, 81. However, in dicta, the Chief Justice observed that "when a State proceeds to regulate commerce with foreign nations, or among the several States, it is exercising the very power that is granted to Congress, and is doing the very thing which Congress is authorized to do." Id. at 76.
91. 53 U.S. (12 How.) 299 (1851) (overruled in part by Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977)). See generally DAN T. COENEN, CONSTITUTIONAL LAW: THE COMMERCE CLAUSE 217-18 (2004) ("the Court came together . . . to declare that the grant of commerce power in and of itself barred some state legislation by rendering congressional power 'exclusive' as to 'subjects . . . in their nature national.'").
93. Id. at 318.
94. Id. at 319.
served that the nature of certain subjects required a uniform national standard, while the nature of others required national diversity in order to meet local needs. State laws falling into the former category, the Court opined, would be struck down even in the absence of federal legislation, while state laws falling into the latter category would be upheld, provided that no federal law preempted it. Because the Court determined that the Pennsylvania law at issue fell into the latter category, the Court upheld it.

Since *Cooley*, the Court's framework for deciding Dormant Commerce Clause cases has evolved considerably. From a functional standpoint, modern cases now analyze allegedly unconstitutional state laws based upon whether or not they discriminate against interstate commerce. On the one hand, the Court has held that a discriminatory law—i.e., a law that treats in-state and out-of-state economic interests differently to the benefit of the former and to the detriment of the latter—is subject to a virtually per se rule of invalidity. For instance, in *City of Philadelphia v. New Jersey* the Court invalidated a New Jersey law that prohibited the importation of most solid and liquid waste originating outside of the State. In reaching its decision, the Court relied on the fact that the law imposed the full burden of conserving New Jersey’s remaining landfill space on out-of-state commercial entities. According to the Court, this economic barrier was exactly the sort of scheme the Commerce Clause prohibited and was thus unconstitutional.

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95. *Id.* Justice Curtis observed:

> [T]he power to regulate commerce, embraces a vast field, containing not only many, but exceedingly various subjects, quite unlike in their nature; some imperatively demanding a single uniform rule, operating equally on the commerce of the United States in every port; and some, like the subject now in question, as imperatively demanding that diversity, which alone can meet the local necessities of navigation.

*Id.*

96. *Id.* at 319-21.


100. See *City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978); see also *supra* text accompanying note 18 and 19.


102. *Id.* at 628-29.

103. *Id.*

104. *Id.*
On the other hand, the Court held in *Pike v. Bruce Church, Inc.* that even a nondiscriminatory law—i.e., a law that regulates even-handedly—should be invalidated if its burden on interstate commerce is clearly excessive in relation to its purported local benefits. In *Pike*, the Court invalidated an Arizona law that required Arizona-grown cantaloupes to advertise their State of origin on their packages. The majority determine the burden of forcing Arizona growers to use packaging facilities—whether located in-state or out-of-state—that would place the required identification on the package was simply too great in relation to the putative local benefit of enhancing the reputation of in-state growers. The Court therefore determined that, although the law applied even-handedly, it had to fail based on the degree of encumbrance it imposed on interstate commerce.

From a fundamental standpoint, the Court has stated that the goal of the modern approach is to effectuate the Framers' intent for national unity with respect to interstate commerce in order to prevent the economic "Balkanization" that wreaked havoc on the economies of the States under the Articles of Confederation. Given this goal, the Court has determined that certain genera of cases should be accorded a different analysis because they do not burden interstate commerce in a way that the Dormant Commerce Clause was designed to prevent. Indeed, the most recent variation from the standard discrimination/non-discrimination line of analysis—the "government function" exception—was first communicated in the dissent in *C & A Carbone, Inc. v. Clarkstown.*

*Carbone* involved a "flow control" ordinance that required trash haulers to remit solid refuse to a privately owned and operated waste processing facility. The ordinance was adopted in order

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106. *Id.* at 142; see also *supra* text accompanying note 20.
107. *Id.* at 146.
108. *Id.* at 143-45.
109. *Id.*
110. "Balkanization" means "to break up (as a region) into smaller ineffectual and frequently conflicting units." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 166 (Philip Babcock Gove ed., Merriam Webster, Inc. 1986) (1961) (defining "balkanize").
112. *See* Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 810 (1976) (articulating the "market-participant" exception); *United Haulers*, 127 S. Ct. at 1796 (espousing the "government function" variation).
114. *Id.* at 386-87 (majority opinion). Justice Kennedy delivered the majority opinion and was joined by Justices Stevens, Scalia, Thomas, and Ginsburg. *Id.* at 384.
to allow the town of Clarkstown to fulfill contractual obligations to the private company that built the facility.\textsuperscript{115} Under the terms of the contract, Clarkstown guaranteed the facility a certain tonnage of waste per year, for which the contractor could charge an above-market-rate "tipping fee."\textsuperscript{116} At the end of the contract term, the town would then buy the facility for the nominal amount of $1.\textsuperscript{117} Thus, the agreement, coupled with the flow control ordinance, allowed the town to finance the building of a facility that it would eventually own and operate.\textsuperscript{118}

The ordinance was challenged on the assertion that it unconstitutionally discriminated against interstate commerce.\textsuperscript{119} While the majority agreed that it did indeed violate the Dormant Commerce Clause because it favored an in-state processor over out-of-state competition,\textsuperscript{120} the dissent drew an important distinction between this particular ordinance and other laws that were struck down based on their discriminatory effects.\textsuperscript{121} According to Justice Souter, the processing facility—despite the fact that a private company held title—was essentially a municipal facility.\textsuperscript{122} In support of this assertion, he indicated that the facility itself performed a function traditionally falling to state or local government.\textsuperscript{123} Furthermore, he noted that the town would eventually own the facility.\textsuperscript{124} This background knowledge, Justice Souter contended, made the flow control ordinance fundamentally different from laws favoring purely private interests because laws favoring local government—as this law did—were more likely aimed at

\textsuperscript{115} Id. at 387.
\textsuperscript{116} Id. at 386-87. "Tipping fees are disposal charges levied against collectors who drop off waste at a processing facility. They are called 'tipping' fees because garbage trucks literally tip their back end to dump out carried waste." United Haulers, 127 S. Ct. at 1791.
\textsuperscript{117} Carbone, 511 U.S. at 387.
\textsuperscript{118} Id. The Court observed: "The object of this arrangement was to amortize the cost of the transfer station. The town would finance its new facility with the income generated by the tipping fees." Id.
\textsuperscript{119} Id. at 388.
\textsuperscript{120} Id. at 391. The majority stated: "the flow control ordinance is just one more instance of local processing requirements we have held invalid." Id.
\textsuperscript{121} Id. at 411 (Souter, J., dissenting).
\textsuperscript{122} Carbone, 511 U.S. at 419 (Souter, J., dissenting).
\textsuperscript{123} Id.
\textsuperscript{124} Id. Justice Souter contended:

While our previous local processing cases have barred discrimination in markets served by private companies, Clarkstown's transfer station is essentially a municipal facility, built and operated under a contract with the municipality and soon to revert entirely to municipal ownership. This, of course, is no mere coincidence, since the facility performs a municipal function that tradition as well as state and federal law recognize as the domain of local government.

\textit{Id.}
serving the public interest rather than at economic protectionism. As such, he declared that they were deserving of different constitutional treatment under the Dormant Commerce Clause. Therefore, he found the majority's invalidation of the law under traditional principles unwarranted.

The Court's first examination of the public-private distinction espoused by the Carbone dissenters came in United Haulers Ass'n v. Oneida-Herkimer Solid Waste Management Authority, a case involving a flow control ordinance very similar to the one in Carbone. Unlike Carbone, however, the ordinance in United Haulers required trash haulers to remit solid refuse to a publicly owned and operated processing facility. In deciding whether the ordinance discriminated against interstate commerce for Dormant Commerce Clause purposes, the Court deemed it necessary to distinguish its Carbone decision. Chief Justice Roberts observed that the Carbone majority did not address the public-private distinction made by the dissent. As a result, he concluded that that case left open the question of whether laws favoring local government over private business should be treated differently than laws aimed at protecting local private entities over out-of-state competition. The Chief Justice found compelling reasons for answering in the affirmative.

125. Id. at 420-21. The dissent stated: 
[Private businesses, whether local or out of State, first serve the private interests of their owners, and there is therefore only rarely a reason other than economic protectionism for favoring local businesses over their out-of-town competitors. The local government itself occupies a very different market position, however, being the one entity that enters the market to serve the public interest of local citizens quite apart from private interest in private gain. Reasons other than economic protectionism are accordingly more likely to explain the design and effect of an ordinance that favors a public facility.

126. Id. at 421.
127. Carbone, 511 U.S. at 422-23.
129. United Haulers, 127 S. Ct. at 1790.
130. Id.
131. Id. Chief Justice Roberts delivered the majority opinion and was joined by Justices Souter, Ginsburg, Breyer, and Scalia. Id. at 1789-90.
132. Id. at 1793-94.
133. Id. at 1794. The Chief Justice noted that, "as the Second Circuit explained, 'in Carbone the Justices were divided over the fact of whether the favored facility was public or private, rather than on the import of that distinction.'" Id. (quoting United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 261 F. 3d 255, 259 (2d Cir. 2001) (emphasis in original)).
134. United Haulers, 127 S. Ct. at 1795.
He noted that the notion of discrimination presupposes a juxtaposition of substantially similar entities. To that extent, he remarked that government and private business were two distinct entities with separate objectives. Unlike private business, citizens entrust government with the responsibility of protecting health, safety, and welfare. Given these general objectives, the majority deduced that laws favoring State or local government were less likely to be aimed at economic protection and more likely to be directed at allowing government to do that which its citizens entrust it to do. Moreover, the majority surmised, the alternative approach would lead to unprecedented and illimitable judicial interference with the administration of state and local government. As a result, the Court concluded that the flow control ordinance did not discriminate against interstate commerce for purposes of the Dormant Commerce Clause.

After coming to their respective conclusions on the public-private distinction, the dissent in Carbone and a plurality in United Haulers found it necessary to analyze the flow control ordinances under the Pike test. Both noted that courts employ this test when they determine that a challenged law does not by its terms discriminate but rather is aimed at legitimate local concerns and has only incidental effects on interstate commerce. Both observed that the test provides that a nondiscriminatory law

135. Id. (quoting General Motors Corp. v. Tracy, 519 U.S. 278, 298 (1997)).
136. Id.
137. Id.
138. Id. at 1795-96. Chief Justice Roberts wrote:
As our local processing cases demonstrate, when a law favors in-state business over out-of-state competition, rigorous scrutiny is appropriate because the law is often the product of "simple economic protectionism." Laws favoring local government, by contrast, may be directed toward any number of legitimate goals unrelated to protectionism. Here the flow control ordinances enable the Counties to pursue particular policies with respect to the handling and treatment of waste generated in the Counties, while allocating the costs of those policies on citizens and businesses according to the volume of waste they generate.

Id. (internal citations omitted).
139. United Haulers, 127 S. Ct. at 1796.
140. Id. at 1797.
141. Carbone, 511 U.S. at 423 (Souter, J., dissenting); United Haulers, 127 S. Ct. at 1789.
142. United Haulers, 127 S. Ct. at 1797; Carbone 511 U.S. at 423. The United Haulers Court affirmed that the Pike test is "reserved for local laws 'directed to legitimate local concerns, with effects upon interstate commerce that are only incidental.'" United Haulers, 127 S. Ct. at 1797 (citing City of Philadelphia v. New Jersey, 437 U.S. at 624).
will be upheld unless its burden on interstate commerce is patently disproportionate to the purported local benefits. 143

Applying the *Pike* test to the facts of *Carbone*, Justice Souter determined that the burdens attendant to the ordinance fell primarily on the citizens of Clarkstown since they would be paying more for the waste processing services. 144 Likewise, he observed that no evidence existed to show that the ordinance resulted in a decrease in trash flow to out-of-state facilities. 145 To the contrary, he commented, the only facility that likely lost business was the Clarkstown facility itself due to its increased tipping fees. 146 When weighed in relation to the putative benefits, Justice Souter determined that the ordinance clearly passed the *Pike* test. 147 Indeed, he remarked, State and local government have a duty to provide safe sanitation services despite whether private enterprise decides to enter the market. 148 Thus, he concluded that the town could legitimately minimize the risk of financing and building a processing facility by entering the arrangement it did. 149

The *United Haulers* plurality likewise found that the ordinance passed the *Pike* test. 150 However, Chief Justice Roberts deemed it unnecessary to consider whether there were any incidental burdens on interstate commerce because he determined that the public benefits outweighed any possible burdens. 151 According to the Chief Justice, the health and environmental benefits resultant from the ordinance in terms of encouraging recycling could not possibly be exceeded by any conceivable burden on interstate commerce. 152 Thus, the plurality sustained the ordinance's validity. 153

143. *United Haulers*, 127 S. Ct. at 1797 (citing *Pike*, 397 U.S. at 142); *Carbone* 511 U.S. at 423 (Souter, J., dissenting) (citing *Pike*, 397 U.S. at 423). See also supra text accompanying note 20.

144. *Carbone*, 511 U.S. at 427 (Souter, J., dissenting).

145. *Id.*

146. *Id.* at 428.

147. *Id.*

148. *Id.*

149. *Carbone*, 511 U.S. at 429. The dissent observed: "Protection of the public fisc is a legitimate local benefit directly advanced by the ordinance and quite unlike the generalized advantage to local business that we have condemned as protectionist in the past." *Id.*

150. *United Haulers*, 127 S. Ct. at 1797 (plurality opinion).

151. *Id.*

152. *Id.* at 1798. The plurality stated: "First, they create enhanced incentives for recycling and proper disposal of other kinds of waste.... Second, by requiring all waste to be deposited at Authority facilities, the Counties have markedly increased their ability to enforce recycling laws." *Id.*

153. *Id.*
When looking at *Davis* in light of *Carbone* and *United Haulers*, two noteworthy issues present themselves. The first issue is reconciling the *Davis* rationale with that of *United Haulers* in so far as determining whether unconstitutional discrimination exists. Indeed, the *Davis* Court opined that the tax program was unlikely to be aimed at economic protectionism because it favored and helped fund a "government function." Moreover, it asserted that Kentucky's tax law favored a public enterprise while treating all private businesses the same. For this proposition, the Court relied on a Full Faith and Credit Clause case from 1882 in which the Court held that a State should be treated as a private entity with regard to municipal bonds that leave its borders. All of this background considered, the Court concluded that the tax scheme did not discriminate against interstate commerce for Commerce Clause purposes.

But that line of reasoning does not exactly comport with the *United Haulers* rationale. In *United Haulers*, the Court held that States and municipalities were unlike private business because they act with different objectives, not likely to be aimed at economic protectionism. It was this reason that made the private and public entities not substantially similar and worthy of a different level of constitutional scrutiny. The incongruity lies in the fact that the tax law at issue in *Davis* did not imply that Kentucky acted with objectives different from those of other states. To the contrary, Kentucky's law is almost identical to the laws of thirty-six other States and comparable to the laws of five other. Also, states that have enacted a law similar to Kentucky's have the exact same objective: protect-

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155. *Id.* at 1811.
156. The Full Faith and Credit Clause provides: "Full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state." U.S. CONST. art. IV, § 1.
157. *Davis*, 128 S. Ct. at 1811 (citing *Bonaparte*, 104 U.S. at 595). The Bonaparte Court held:
It is true, if a State could protect its securities from taxation everywhere, it might succeed in borrowing money at reduced interest; but, inasmuch as it cannot secure such exemption outside of its own jurisdiction, it is compelled to go into the market as a borrower, subject to the same disabilities in this particular as individuals.

*Bonaparte*, 104 U.S. at 595.
159. *United Haulers*, 127 S. Ct. at 1795.
160. *Id.* at 1795-96.
ing the health, safety, and welfare of their citizens.\textsuperscript{162} So in reality, both the public enterprise and the “private” enterprise in \textit{Davis} were acting with the same motivation. In that sense, they are substantially similar. The only way they can possibly be considered different is to draw the technical distinction employed by the \textit{Davis} majority. The Court therefore seems to have elevated form over substance in terms of deciding whether or not the law “discriminated” for purposes of the Dormant Commerce Clause. Thus, Justice Souter appears to have committed the same sort of formalistic error that he argued so vigorously against in his \textit{Carbone} dissent.\textsuperscript{163} The result reached in \textit{Davis} is not necessarily bad, however, because the opposite outcome could have had a potentially devastating economic impact. Nonetheless, it does suggest that the Court was stretching the bounds of its recently articulated “government function” exception in order to obtain the desired result without going outside of its own decisional law. Perhaps, then, the majority would have been better served if it had not tried to circumvent the fact that the law in question did discriminate and taken Justice Kennedy’s advice concerning a \textit{sui generis} exception.\textsuperscript{164}

This discussion leads to the second issue presented by the \textit{Davis} decision: the continued viability of the \textit{Pike} test.\textsuperscript{165} Despite its application by the \textit{United Haulers} plurality and the \textit{Carbone} dissent, the \textit{Davis} Court left open the question of whether \textit{Pike} should apply to the Court’s “government function” cases.\textsuperscript{166} Though interesting, this decision is unsurprising. Because the Kentucky law at issue did in a very real way discriminate against interstate commerce, it would have been very difficult for the Court to conduct any meaningful analysis. Moreover, by inviting a challenge to \textit{Pike} as it applies to the “government function” case, the Court will be sure to give itself the opportunity to clarify and refine the scope of the exception.

What was interesting as well as surprising, however, was majority’s seemingly more general criticism of \textit{Pike}.\textsuperscript{167} Indeed, by noting its own institutional inadequacy for engaging in the subtle

\textsuperscript{162. See id. at 1805-07.  
163. See \textit{Carbone}, 511 U.S. at 419-21.  
164. \textit{Davis}, 128 S. Ct. at 1830.  
165. \textit{Id.} at 1817.  
166. \textit{Id.} at 1817-19. Interestingly, Justice Souter couched his \textit{Pike} comments in more comprehensive terms, perhaps hinting at the test’s general inadequacy. See \textit{id.}  
167. See \textit{id.} at 1817-19.}
cost-benefit analysis that *Pike* requires, the Court may be positioning itself for a wholesale abandonment of the doctrine. The result would be the demise of a staple principle that is perhaps the most disagreeable aspect of the Dormant Commerce Clause.

In conclusion, *Davis* highlights the difficulties that courts will encounter in applying the new “government function” caveat. To be sure, its feasibility and overall sphere of influence remain to be seen. One thing is certain, however. Litigation involving the Dormant Commerce Clause and the meaning and extent of the “government function” exception is certain to follow.

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168. *Id.* at 1817-18.

