

1-20-2010

The Supreme Court Lends States a Break: Department of Revenue of Kentucky v. Davis and the Civic Responsibility Exception to the Negative Commerce Clause

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Recommended Citation

Ryan D. Wheeler *The Supreme Court Lends States a Break: Department of Revenue of Kentucky v. Davis and the Civic Responsibility Exception to the Negative Commerce Clause*, 37 Pepp. L. Rev. Iss. 1 (2010)
Available at: <https://digitalcommons.pepperdine.edu/plr/vol37/iss1/5>

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**The Supreme Court Lends States a
Break:
*Department of Revenue of Kentucky v.
Davis*
and the Civic Responsibility Exception
to the Negative Commerce Clause**

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I. INTRODUCTION

The vast majority of all American states exempt the gains their residents earn on in-state municipal bonds from personal state income tax¹ while

1. "A municipal bond is a debt obligation running from the issuing state to the bondholder." Scott K. Attaway, *The Case for Constitutional Discrimination in Taxation of Out-of-State Municipal*

simultaneously taxing the gains their residents earn on out-of-state municipal bonds.² States and municipalities have long issued bonds³ in order to “finance everything from bridge repair to school construction and water-system upgrades.”⁴ The current fiscal crisis afflicting the United States increases the likelihood that municipal bonds will become even more vital as states and cities seek solutions to their budget shortfalls.⁵ The

Bonds, 76 B.U. L. REV. 737, 740 (1996).

2. See Adam Pekor, 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, 807–08 (2007) (noting that forty-two states have some form of differential bond taxation scheme). The rationale behind such a differential taxation scheme is found in Justice Souter’s opinion for the Court in *Davis*. When a state offers tax-exempt bonds, it is able to pay a lower rate of interest on the principal while still remaining competitive in the market. See *Dep’t of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1805 (2008). For example, a private issuer might sell a bond for \$10,000 with a 10% rate of return. The gain on such a bond would be \$1,000 before state income tax. If a marginal rate of 25% is assumed, then the net gain for the individual bond buyer would be \$750. Under the differential taxation scheme, the state can issue a \$10,000 bond, but pay only 7.5% interest on the principal because the buyer of a municipal bond will not be forced to pay income tax on the gain. Therefore, the 7.5% gain on the state-issued municipal bond would be \$750, and without any state income tax to pay, the net gain to the buyer is the same in either scenario. The incentive to the state is the ability to save the hypothetical 2.5% interest on principal. See, e.g., *id.* The desirability of a tax-free municipal bond may depend on the marginal income tax rate of the potential bond buyer. In the example above, someone in a hypothetical 15% marginal income tax rate would be better served by purchasing a bond from a private issuer paying 10% interest because their taxes would only total \$150, leaving a net gain of \$850 (outperforming the tax-free municipal bond by \$100). Conversely, a tax payer in a hypothetical 35% marginal income tax rate would be far better served by the municipal bond’s net gain of \$750, as a privately issued bond paying 10% would only net \$650.

3. See Attaway, *supra* note 1, at 740 (noting that states and municipalities often use municipal bonds to fund large scale capital projects). Municipal bonds have been utilized in North America since at least the 1740s when the colony of Massachusetts first issued bonds. See JOSEPH C. DALEY ET AL., A GUIDE TO MUNICIPAL OFFICIAL STATEMENTS 4 n.3 (2d ed. Prentice Hall Law & Business 1990).

4. See G. Jeffrey MacDonald, *Municipal Bonds: An Investment with Civic Pride*, THE CHRISTIAN SCIENCE MONITOR, <http://www.csmonitor.com/2008/1027/p13s01-wmgn.html> (stating that, as of October 2008, the total market for municipal bonds totaled a staggering \$2.66 trillion); see also AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS, <http://www.treasurer.ca.gov/bonds/debt/200812/authorized.pdf> (noting that the state of California has issued bonds to pay for improvements for decades). California has issued bonds to fund school facilities, park and recreation facilities, water improvements, correctional facilities, disaster preparedness, emergency shelters, traffic reduction programs, passenger rail systems, coastal protection, stem cell research, veterans’ homes, fish and wildlife habitats, air quality improvements, and library construction. *Id.* As of December 1, 2008, California’s long-term outstanding bonds totaled \$56,944,224,000 with an additional \$56,830,314,000 in bonds that have been authorized but not yet issued. *Id.*

5. See MacDonald, *supra* note 4. For instance, in October of 2008, California successfully sold four billion dollars in bonds in order to avoid a shutdown of the state government due to a budgetary shortfall. *Id.* The state’s need to sell bonds was so great that Governor Arnold Schwarzenegger appeared in ads urging Californians to buy the debt. Marc Lifsher, Federal debt-purchasing program may exclude states, L.A. TIMES, Oct. 9, 2008, at C1, available at <http://articles.latimes.com/2008/oct/09/business/fi-calbai9>. Indeed, every state vigorously argued that the Court should allow the differential taxation system to remain in place because the current bond system represents the best way for states to finance many projects. Brief for the States of North Carolina et al. as Amici Curiae

importance of the tax exemption for municipal bonds is clear—without it, states and cities would be forced to raise the interest rates on their bonds in order to compete with private issuers in a time when competition with the private sector is already extremely difficult and states and cities are having trouble selling debt due to the credit crunch.⁶

In *Department of Revenue of Kentucky v. Davis*, the Supreme Court of the United States considered whether this differential taxation scheme, which heavily affects the viability of municipal bonds, violates the negative Commerce Clause.⁷ George and Catherine Davis, residents of the state of Kentucky, owned out-of-state municipal bonds and were forced to pay income tax on their gains.⁸ The Davises claimed that the state used its taxing power to impermissibly discriminate against out-of-state bonds by creating a financial incentive to purchase in-state bonds.⁹

The Supreme Court of the United States, in a highly fractured decision, held that the Kentucky statute did not violate the negative Commerce Clause.¹⁰ In so doing, Justice Souter, writing for the Court, reaffirmed and clarified the Court's new civic responsibility exception¹¹ as first detailed in

In Support of Petitioners at 9, *Dep't of Revenue of Ky. v. Davis*, 128 S. Ct. 1801 (2008) (No. 06-666), 2007 WL 2115445. The States noted that "[t]he tax exemption not only allows States to obtain more favorable financing terms, it also gives States the option of borrowing greater sums without jeopardizing their credit ratings." *Id.* at 10. The States warned that the cost of borrowing money would become unacceptably high if they were unable to maintain their credit ratings. *Id.* As the system is currently set up, the bonds "allow States to undertake necessary capital improvements without having to impose exorbitant taxes, [and] they also allow States to spread the cost of the project over its life." *Id.* at 9.

6. See, e.g., Ian Salisbury, *Home-State Muni Funds Carry Risks*, WALL ST. J., Jan. 14, 2009, available at <http://online.wsj.com/article/SB123198481288484261.html> (noting that "[t]he credit crisis has made muni yields unusually attractive. Vanguard Intermediate-Term Tax-Exempt Fund, one that several advisers cited for its low costs, currently yields about 3.7%, well above the 1.6% yield on five-year Treasuries."). However, the risks of investing in a municipal bond are even greater today because while it is still unlikely that a municipal bond will default, "investors can see significant losses if a state's bonds are downgraded by ratings agencies." *Id.* Despite a perceived increased risk in municipal bonds, Bill Lockyear, the state treasurer of California, stated that "[t]he only way we're going to default is if there's a thermonuclear war." Brett Arends, *The Golden State's Golden Buying Opportunity?*, WALL ST. J., Jan. 8, 2009, <http://online.wsj.com/article/SB123144936055465507.html>.

7. *Davis*, 128 S. Ct. 1801, 1801 (2008). For more on the negative Commerce Clause, see *infra* notes 29–32 and accompanying text.

8. *Davis*, 128 S. Ct. at 1807.

9. *Id.* Specifically, Kentucky exempts income tax on gains derived from in-state bonds while "interest income derived from obligations of sister states and political subdivisions thereof," remains taxable income. See KY. REV. ST. ANN. § 141.010(10)(c) (West 2006).

10. *Davis*, 128 S. Ct. at 1819.

11. The name "civic responsibility exception" was coined by the author. In both Chief Justice Roberts and Justice Souter's formulation of the rule, the key to immunity is that the government

United Haulers Ass'n v. Oneida-Herkimer Solid Waste Management Authority.¹² In *United Haulers*, the Court held that state and local laws may favor the government so long as all private in-state and out-of-state businesses are treated exactly the same.¹³ In addition to the precedent from *United Haulers*, Justice Souter went as far as to say that Kentucky's issuance and taxation of bonds falls under the market participant doctrine.¹⁴ However, this portion of his opinion did not gain the majority of the Court's favor.¹⁵ In addition, Justice Souter, again writing for the majority, declined to apply the *Pike* balancing test at all, stating that the judiciary is an unsuitable forum in which to weigh the advantages and the disadvantages of such a differential taxation scheme, and instead showed a strong preference to defer to elected legislators to make such decisions.¹⁶ By holding that these differential taxation schemes do not violate the negative Commerce Clause, has the Roberts Court signaled both an increasing preference toward federalism while simultaneously suggesting that courts should be deferential to the various legislative bodies and those bodies' balancing of competing policy interests?

This case note will discuss the Court's adoption of the new civic responsibility exception to the negative Commerce Clause, with particular

entity must have enacted the statute in question in order to further a traditional government activity, which essentially boils down to a government's civic responsibility. Harvard Law Review suggests the phrase "government entity exemption" to describe the Court's new exception to the negative Commerce Clause. See *Dormant Commerce Clause—State Taxation of Municipal Bonds*, 122 HARV. L. REV. 276, 276 (2008). However, "government entity exemption" does not properly characterize the exception. Indeed, the phrase is too broad and could easily engulf the market participant doctrine as a government entity necessarily acts whenever the market participant doctrine applies. In addition, when the *United Haulers* and *Davis* exception applies, it will not always be the case that a government entity will be exempted simply because of its character as a governmental institution. Rather, it is what the government *does* that matters, in that the government must be pursuing a traditional government function in furtherance of its civic responsibilities while treating all private in-state and out-of-state businesses the same. Thus "civic responsibility exception" denotes the rule much more appropriately.

12. *Id.* at 276–77; see *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1795 (2007).

13. *United Haulers*, 127 S. Ct. at 1795; *Davis*, 128 S. Ct. at 1811 ("Just like the ordinances upheld there, Kentucky's tax exemption favors a traditional government function without any differential treatment favoring local entities over substantially similar out-of-state interests."). For more on *United Haulers*, see *infra* notes 59–64 and accompanying text.

14. See *Davis*, 128 S. Ct. at 1811–14.

15. *Id.* at 1804, 1811–17. The Chief Justice summarizes his analysis on the prudence of applying the market participant doctrine in this specific instance by stating that "[i]n my view, the case is readily resolved by last Term's decision in *United Haulers*." *Id.* at 1821 (Roberts, C.J., concurring in part); see also *infra* note 120 and accompanying text.

16. *Davis*, 128 S. Ct. at 1818 (majority opinion) ("What is most significant about these cost-benefit questions is not even the difficulty of answering them or the inevitable uncertainty of the predictions that might be made in trying to come up with answers, but the unsuitability of the judicial process and judicial forums for making whatever predictions and reaching whatever answers are possible at all."); see *infra* notes 104–110 and accompanying text.

emphasis on the Court's analysis in reaching that conclusion, the Court's preference for federalism, its hesitance to apply the *Pike* balancing test, and its uncertainty with regard to the interplay between the market participant doctrine and the civic responsibility exception. Part II will explore the history of the negative Commerce Clause and trace the Court's development of the relevant tests which determine when the Clause has been violated.¹⁷ Part III will detail the facts of *Department of Revenue of Kentucky v. Davis*.¹⁸ Part IV¹⁹ will analyze all seven opinions, starting with the majority opinion by Justice Souter;²⁰ concurrences by Justice Stevens,²¹ Chief Justice Roberts,²² Justice Scalia,²³ and Justice Thomas;²⁴ and finally dissents by Justices Kennedy²⁵ and Alito.²⁶ Part V will explore both the legal and broader consequences of this decision.²⁷ Finally, Part VI will conclude the case note.²⁸

II. HISTORICAL BACKGROUND OF THE NEGATIVE COMMERCE CLAUSE

The Commerce Clause of the United States Constitution gives Congress the power to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."²⁹ Out of the Commerce Clause, the Supreme Court found an implicit limit on the states' ability to regulate commerce, whether or not Congress previously legislated on an issue.³⁰

17. See *infra* notes 29–64 and accompanying text.

18. See *infra* notes 65–72 and accompanying text.

19. See *infra* notes 73–167 and accompanying text.

20. See *infra* notes 73–113 and accompanying text.

21. See *infra* notes 114–118 and accompanying text.

22. See *infra* notes 119–120 and accompanying text.

23. See *infra* notes 121–127 and accompanying text.

24. See *infra* notes 128–134 and accompanying text.

25. See *infra* notes 135–165 and accompanying text.

26. See *infra* notes 166–167 and accompanying text.

27. See *infra* notes 168–188 and accompanying text.

28. See *infra* note 189 and accompanying text.

29. U.S. CONST. art. I, § 8, cl. 3.

30. The negative Commerce Clause first became an accepted theory in *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299 (1851). Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569, 577 (1987). In *Cooley*, the Court considered whether a Pennsylvania statute that required boats entering or exiting Philadelphia's port to use a local pilot violated the Commerce Clause. *Id.* (citing *Cooley*, 53 U.S. (12 How.) at 311–12). Justice Curtis, writing for the Court and upholding the statute, decided that Congress did not have exclusive control over commerce in the Constitution because Congress had, in the past, delegated powers over commerce to the states. *Id.* at 577–78 (citing *Cooley*, 53 U.S. (12 How.) at 317–18). To some degree, Justice Curtis' motivations in ruling that the states had some

Despite heavy criticism from some members of the Court,³¹ the negative Commerce Clause remains an established doctrine today.³²

power over commerce may have been political. *Id.* at 579 (“[H]e struck a pre-Civil War judicial compromise. His approach simultaneously avoided confrontation with states’ rights advocates, yet reserved for the Court the ability to invalidate objectionable state legislation under a theory of *partial exclusivity*.”). Modernly, the Court has applied a version of the negative Commerce Clause which focuses upon the limits on states to act in a protectionist nature. See *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273 (1988) (“It has long been accepted that the Commerce Clause not only grants Congress the authority to regulate commerce among the States, but also directly limits the power of the States to discriminate against interstate commerce.”); *Freeman v. Hewit*, 329 U.S. 249, 252 (1946) (“[T]he Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States.”). Support for an interpretation of the Constitution under which the states should be limited in their ability to regulate commerce, even where Congress has remained silent, includes an argument from Alexander Hamilton that:

The competitions of commerce would be another fruitful source of contention [among the states]. The states less favourably circumstanced, would be desirous of escaping from the disadvantages of local situation, and of sharing in the advantages of their more fortunate neighbours. Each state, or separate confederacy, would pursue a system of commercial polity peculiar to itself. This would occasion distinctions, preferences, and exclusions, which would beget discontent.

THE FEDERALIST NO. 7, at 28–29 (Alexander Hamilton) (George W. Carey & James McClellan eds., Liberty Fund, Inc. 2001) (1787). Interestingly, the Supreme Court has stated that the Commerce Clause, an enumerated federal power, “also had immediately effected a curtailment of state power.” *Camps Newfoundland/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 571 (1997). Both the words “dormant” and “negative” have been used to describe this unenumerated federal power. *Id.* at 609 n.1 (Thomas, J., dissenting). This note will use the term “negative,” for as Justice Scalia wryly commented, “the ‘negative Commerce Clause’ . . . is ‘negative’ not only because it negates state regulation of commerce, but also because it does *not* appear in the Constitution.” *Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 200 (1995) (Scalia, J., concurring).

31. *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1799 (2007) (Thomas, J., concurring) (“The negative Commerce Clause has no basis in the Constitution and has proved unworkable in practice.”); *Camps Newfoundland*, 520 U.S. at 596 (Scalia, J., dissenting) (“Our cases have struggled (to put it nicely) to develop a set of rules by which we may preserve a national market without needlessly intruding upon the States’ police powers, each exercise of which no doubt has some effect on the commerce of the Nation.”); *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 312 (1997) (Scalia, J., concurring) (“[T]he so-called ‘negative’ Commerce Clause is an unjustified judicial invention, not to be expanded beyond its existing domain.”). The Court is not alone in its criticisms of the negative Commerce Clause. Some commentators have suggested that it is not the Court’s role to determine when a state has overstepped its boundary because “[u]nder the dormant commerce clause, the federal judiciary—the organ of the federal government most insulated from state influence and the organ traditionally feared most by the states—makes the initial legislative judgment whether state regulation of interstate commerce is reasonable.” Redish, *supra* note 30, at 573 (footnote omitted).

32. As Justice Clark stated, “[f]rom the quagmire there emerge . . . some firm peaks of decision which remain unquestioned.” *Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959). Even Justice Scalia has been willing to apply the negative Commerce Clause in situations where *stare decisis* demands that he do so. *United Haulers*, 127 S. Ct. at 1798 (Scalia, J., concurring) (“I have been willing to enforce on *stare decisis* grounds a ‘negative’ self-executing Commerce Clause in two situations: (1) against a state law that facially discriminates against interstate commerce, and (2) against a state law that is indistinguishable from a type of law previously held unconstitutional by the Court.”). Indeed, it appears that only Justice Thomas is categorically unwilling to apply the negative Commerce Clause. *Id.* at 1799 (Thomas, J., concurring) (“As the debate between the majority and dissent shows, application of the negative Commerce Clause turns solely on policy considerations, not on the Constitution. Because this Court

In order to determine whether a state statute violates the negative Commerce Clause, the modern Court first determines whether or not the challenged statute discriminates against only out-of-state commerce.³³ For example, in *City of Philadelphia v. New Jersey*, a New Jersey statute which prohibited the importation of almost all solid or liquid waste into the state was challenged by private landfill operators and cities in other states.³⁴ The Court noted that “where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected.”³⁵ The Court reasoned that because New Jersey only prohibited the importation of waste from out-of-state sources while still allowing landfills to process New Jersey waste, the law was facially discriminatory.³⁶ In concluding, the Court distinguished the garbage import ban from quarantine laws and held that the New Jersey statute violated the negative Commerce Clause.³⁷

has no policy role in regulating interstate commerce, I would discard the Court’s negative Commerce Clause jurisprudence.”); *see infra* notes 123–130 and accompanying text.

33. *See City of Phila. v. New Jersey*, 437 U.S. 617, 624 (1978). Justice Stewart wrote that “[t]he crucial inquiry, therefore, must be directed to determining whether [the statute] is basically a protectionist measure, or whether it can fairly be viewed as a law directed to legitimate local concerns, with effects upon interstate commerce that are only incidental.” *Id.*

34. *Id.* at 618–19. The New Jersey statute did contain an exception that allowed the importation of garbage which would be used to feed animals; waste material which would be recycled; waste which could be used as a secondary material; and hazardous waste which was to be treated, processed and recovered by a facility in New Jersey. *Id.* at 619 n.2. After the New Jersey Supreme Court held that the challenged statute was not a violation of the Commerce Clause, the United States Supreme Court granted certiorari. *Id.* at 620.

35. *Id.* at 624. Justice Stewart, writing for the Court, observed that the clearest example of such a regulation would be one which simply blocked the flow of commerce at a state’s border. *Id.* A discriminatory law will thus only be found constitutionally valid if it “advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.” *Or. Waste Sys., Inc. v. Dep’t of Envtl. Quality of Or.*, 511 U.S. 93, 101 (1994) (quoting *New Energy*, 486 U.S. at 278). However, the bar for a facially discriminatory law to pass constitutional muster has been set high. Justice Brennan, writing for the Court in *Hughes v. Oklahoma*, stated that “facial discrimination by itself may be a fatal defect, regardless of the State’s purpose, . . . [and] [a]t a minimum such facial discrimination invokes the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives.” *Hughes v. Oklahoma*, 441 U.S. 322, 337 (1979) (footnote and citation omitted).

36. *Philadelphia*, 437 U.S. at 626–28. The state claimed that the statute was not designed to protect the state economically, but rather was intended to protect the state’s environment by lessening the need to create new landfill sites, and, further, that this slight burden on interstate commerce was outweighed by the local benefits of environmental protection. *Id.* at 625. The Court, however, did not find the supposed intent of the statute compelling. *Id.* at 626–27 (“But whatever New Jersey’s ultimate purpose, it may not be accomplished by discriminating against articles of commerce coming from outside the State unless there is some reason, apart from their origin, to treat them differently.”).

37. *Id.* at 629. The state argued that the Supreme Court had, in the past, allowed facially discriminatory quarantine laws to pass Constitutional muster. *Id.* at 628. However, Justice Stewart

While *Philadelphia* provides the standard for cases in which a statute is facially discriminatory, *Pike v. Bruce Church, Inc.* represents the Court's application of the negative Commerce Clause to the situation in which there is no discrimination for the forbidden purpose of economic protectionism.³⁸ In *Pike*, the Court considered an Arizona statute that required fruit and vegetables grown in Arizona to be packaged in-state before being transported out-of-state.³⁹ The Court stated a general rule that, when a statute regulates evenhandedly, it will be upheld unless the burden on commerce outweighs the local benefit.⁴⁰ In *Pike*, the heavy financial burden of forcing the producer to build an entirely new packaging plant in Arizona was found to outweigh the slight benefit of packaging according to Arizona's standards, and therefore the statute was found to violate the negative Commerce Clause.⁴¹

stated that those quarantine laws, banning things such as diseased cattle, "did not discriminate against interstate commerce as such, but simply prevented traffic in noxious articles, whatever their origin." *Id.* at 629. In contrast, the New Jersey law simply erected a trade barrier, as there was no logical reason to ban out-of-state waste while still allowing the transportation of in-state waste. *Id.* Justice Rehnquist, writing for the dissent, characterized the Court's holding as an unacceptable Hobson's choice of either accepting waste from all of the other states or shutting down its landfills such that both out-of-state *and* in-state waste could not be disposed of efficiently. *Id.* at 631 (Rehnquist, J., dissenting). Justice Rehnquist found merit to the state's argument that the New Jersey statute was akin to a constitutionally valid quarantine law, noting that there is "no way to distinguish solid waste, on the record of this case, from germ-infected rags, diseased meat, and other noxious items." *Id.* at 632.

38. *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970).

39. *Id.* at 138. A California fruit company, which grew cantaloupes in Arizona, challenged the statute as a violation of the negative Commerce Clause. *Id.* The company had extensive packaging facilities already built thirty-one miles away in California, and thus wished to package its goods at its California facility rather than be forced to construct a new packaging facility in Arizona. *Id.* at 139-40. Arizona argued that all it wanted to regulate was the *intrastate* packaging of goods, which would take place before the goods entered the interstate market. *Id.* at 140. According to the state, the primary purpose of the act was "to promote and preserve the reputation of Arizona growers by prohibiting deceptive packaging." *Id.* at 143. Arizona's fear was that some growers would package inferior fruits or vegetables, resulting in an adverse effect on the reputation of all Arizona growers. *Id.*

40. *Id.* at 142. Justice Stewart's now famous *Pike* balancing test, in whole, is as follows:

Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Id. (citation omitted).

41. *Id.* at 145. In this case, given that the quality of cantaloupes grown was very high, the Court found that the state interest in requiring packaging in Arizona was simply to inform consumers that Arizona produced great fruit. *Id.* Against this benefit, which the Court assumed to be legitimate, the Court balanced the \$200,000 capital investment that would have been needed to build a new packaging plant in Arizona. *Id.* The Court found that the burden outweighed the rather slight local benefit, noting that "the Court has viewed with particular suspicion state statutes requiring business

The Court has also developed a major exception to the negative Commerce Clause, which has become known as the market participant doctrine.⁴² In *Hughes v. Alexandria Scrap Corp.*, a Virginia-based scrap processor challenged a Maryland statute which effectively precluded out-of-state processors from participating in a state-funded hulk bounty program.⁴³ Upon reviewing past precedent, the Court decided that this case was unique in that the state was not trying to regulate the flow of hulks but had instead entered the market as a participant.⁴⁴ The Court held that because the Commerce Clause was designed to prevent states from erecting trade barriers and not from entering the market as a buyer or seller of goods, the Maryland statute did not violate the negative Commerce Clause.⁴⁵

operations to be performed in the home State that could more efficiently be performed elsewhere.” *Id.* Justice Stewart intimated that had the state interest been more substantial it might have outweighed the burden, and thus the statute would have been upheld. *Id.* at 146.

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

43. *Id.* at 799–802. The program was an attempt by the state of Maryland to reduce the amount of unsightly abandoned cars in the state. *Id.* at 796. As part of the program, Maryland offered a bounty to both wreckers and processors, in hopes that the monetary incentive would encourage them to dispose of more vehicles. *Id.* at 797. Proof of title was generally needed in order to receive the bounty from the state. *Id.* The state created a new category for cars older than eight years old which were inoperable and called them “hulks.” *Id.* at 798. In order to speed the legal process, the state decided not to require proof of title for hulks. *Id.* at 798–99. However, beginning in 1974, Maryland amended the statute and began to require title documentation once again. *Id.* at 800. The issue was that while in-state processors only needed a simple indemnity agreement, out-of-state processors were required to submit real proof of title, such as a certificate of title or a bill of sale. *Id.* 800–01. The effect of the new statutory scheme was to encourage Maryland processors to participate in the bounty program while simultaneously discouraging out-of-state processors to participate due to the enhanced burden of proving title. *Id.* at 802. According to Justice Powell, the hulks tended to remain within Maryland instead of traveling to processors out-of-state. *Id.*

44. *Id.* at 805–06.

45. *Id.* at 809–10. Justice Powell noted that this was the first time that the Court had been asked to hold that a state, as a market participant, could not restrict trade to its own citizens or businesses. *Id.* at 808. The Court forcefully stated that “[n]othing in the purposes animating the Commerce Clause prohibits a State, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others.” *Id.* at 810 (footnote omitted). In response, Justice Brennan, writing for the dissent, blasted the Court for “its reinterpretation of the Commerce Clause and its repudiation of established principles guiding judicial analysis thereunder.” *Id.* at 817 (Brennan, J., dissenting). Justice Brennan argued that:

[S]tate statutes that facially or in practical effect restrict state purchases of items in interstate commerce to those produced within the State are invalid unless justified by asserted state interests—other than economic protectionism—in regulating matters of local concern for which “reasonable nondiscriminatory alternatives, adequate to conserve legitimate local interests, are [not] available.”

Id. at 823 (quoting *Dean Milk Co. v. Madison*, 340 U.S. 349, 354 (1951)). He also questioned whether, even if the market participant doctrine were accepted as stated by the majority, Maryland’s actions in the instant action would fit the definition of a market participant. *Id.* at 824. To Justice Brennan, because the state of Maryland was not purchasing the hulks as the end user and instead was

Reeves v. Stake helped to further refine the market participant doctrine.⁴⁶ In *Reeves*, a ready-mix concrete distributor challenged the State of South Dakota's policy of selling state-manufactured cement to South Dakota customers before fulfilling out-of-state orders.⁴⁷ The Court, in reaffirming *Alexandria Scrap*, noted that the key distinction to draw in negative Commerce Clause cases is whether the state is acting as a market participant or as a market regulator.⁴⁸ In *Reeves*, the Court held that, as a seller of cement, South Dakota fit the definition of a market participant even better than Maryland did in *Alexandria Scrap*, and therefore the state policy did not violate the negative Commerce Clause.⁴⁹

In addition to general negative Commerce Clause principles, the Court has, on numerous occasions, considered cases in which tax credits or subsidies allegedly violated the negative Commerce Clause.⁵⁰ Of interest is

merely handing out bounties as one link in a long chain of transactions, the state should not qualify for protection under the exception to the negative Commerce Clause. *Id.*

46. See *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980).

47. *Id.* at 432–33. South Dakota built its own cement manufacturing plant in 1919. *Id.* at 430. In 1958, *Reeves, Inc.*, a Wyoming company, began an amicable relationship with the South Dakota cement plant, and bought cement from the state for a period of two decades. *Id.* at 432. However, beginning in 1978, the plant no longer had enough cement to serve all customers because of the combination of a slowdown at the plant and a spike in demand for cement nationally. *Id.* at 432. Thereafter, South Dakota sold to South Dakota residents first and then to all others on a first come, first served basis. *Id.* at 432–33. As a result, *Reeves* was not able to purchase cement from the plant and had to cut production by seventy-six percent. *Id.* at 433.

48. *Id.* at 436 (“The basic distinction drawn in *Alexandria Scrap* between States as market participants and States as market regulators makes good sense and sound law.”). The Court also sounded a cautionary note with regard to the proper role of its duties, preferring to allow Congress to take charge. *Id.* at 439. In discussing the balancing of state prerogatives against the need for judicial enforcement of the Commerce Clause, Justice Blackmun noted:

Finally, as this case illustrates, the competing considerations in cases involving state proprietary action often will be subtle, complex, politically charged, and difficult to assess under traditional Commerce Clause analysis. Given these factors, *Alexandria Scrap* wisely recognizes that, as a rule, the adjustment of interests in this context is a task better suited for Congress than this Court.

Id.

49. *Id.* at 440. The Court also distinguished the case from situations in which a state impermissibly hoards natural resources, reasoning that cement is not a natural resource but rather the end product of a manufacturing process. *Id.* at 443–44.

50. See, e.g., *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 588 (1997) (holding that a Maine statute which provided a greater tax exemption for charitable institutions that operated principally for the benefit of Maine residents and a more limited exemption for charitable institutions that conducted most of their business with out-of-state residents was a violation of the negative Commerce Clause); *Fulton Corp. v. Faulkner*, 516 U.S. 325, 325, 327 (1996) (holding that a North Carolina statute which “levied an ‘intangibles tax’ on a fraction of the value of corporate stock owned by [] residents inversely proportional to the corporation’s exposure to the State’s income tax” violated the negative Commerce Clause); *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988) (holding that an Ohio statute which provided a tax credit only to Ohio producers or, alternatively, to producers from states which provided Ohio producers a reciprocal tax credit violated the negative Commerce Clause); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 273 (1984) (holding that a Hawaii statute which taxed liquor sold at wholesale, but exempted certain locally produced

New Energy v. Limbach, a 1988 case in which an out-of-state ethanol producer challenged an Ohio statute that provided a tax credit against the Ohio fuel sales tax for ethanol produced either in Ohio or in a state which granted a reciprocal tax credit to Ohio producers.⁵¹ The State claimed that the provision which allowed for reciprocity rendered the law facially neutral, but the Court found this argument unavailing.⁵² In finding that the Ohio statute violated the negative Commerce Clause, Justice Scalia stated that while direct subsidization of an in-state industry usually will not implicate the negative Commerce Clause, a discriminatory tax against an out-of-state business usually will.⁵³

beverages, violated the negative Commerce Clause); *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 407 (1984) (holding that a New York statute that gave corporations a tax credit only when their subsidiaries exported goods from New York violated the negative Commerce Clause); *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 337 (1977) (holding that a New York statute that imposed a greater tax liability on sales of securities executed out-of-state than those executed in-state violated the negative Commerce Clause because “in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State”). In all of these tax cases, the Court considered situations in which a state provided a *private enterprise* with a discriminatory advantage against out-of-state interests. For an introduction to the Court’s modern analysis regarding the public-private distinction in negative Commerce Clause jurisprudence, see *infra* notes 62–64 and accompanying text.

51. *New Energy*, 486 U.S. at 271. Ethanol, usually made from corn in the United States, is mixed with gasoline to make fuel for motor vehicles. *Id.* Considered advantageous because it increases corn demand, is reputed to be good for the environment and may help the United States achieve some measure of energy independence, ethanol is more expensive than regular gasoline to produce, and therefore many states provide a tax credit for ethanol. *Id.* The Ohio statute at issue stated that “[t]he qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the tax commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption.” *Id.* at 272 n.1 (quoting OHIO REV. CODE ANN. § 5735.145(B) (West 2006)).

52. *Id.* at 274. Ohio argued that the provision for reciprocity would actually induce other states to enact similar tax credits, and thus the market for ethanol would expand to the benefit of all Americans. *Id.* Justice Scalia, writing for a unanimous Court, stated that “the promise to remove that [economic disadvantage] if reciprocity is accepted no more justifies disparity of treatment than it would justify categorical exclusion.” *Id.* at 275. Further, the fact that the disparity in tax apparently affected only one out-of-state producer did not matter as “neither a widespread advantage to in-state interests nor a widespread disadvantage to out-of-state competitors [need] be shown.” *Id.* at 276.

53. *Id.* at 278. Ironically, the Indiana company which challenged Ohio’s taxing statute benefited from a subsidy that Indiana gave to ethanol producers. *Id.* However, as Justice Scalia noted, “[t]he Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the State’s regulation of interstate commerce.*” *Id.* For negative Commerce Clause purposes, tax exemptions and subsidies have long been treated differently, with subsidies to in-state industry generally allowed. See Attaway, *supra* note 1, at 745 (“The justification for the distinction may be that, because subsidies must be made annually by legislative appropriation—as opposed to tax exemptions, which are effective until repealed—subsidies have a ‘heightened ‘political visibility.’” (quoting Dan T. Coenen, *Untangling the Market-Participant Exemption to the Dormant Commerce Clause*, 88 MICH. L. REV. 395, 481

In another modern tax case, the Court considered a Maine property tax provision which provided a greater tax break for charitable institutions that operated primarily for the benefit of Maine residents as opposed to those that operated primarily for the benefit of out-of-state residents.⁵⁴ The case marked the first time the Court considered “the disparate real estate tax treatment of a nonprofit service provider based on the residence of the consumers that it serves.”⁵⁵ While the Court concluded that the statute was facially discriminatory,⁵⁶ the more interesting question was whether a tax exemption for a charitable institution, as opposed to a for-profit business, should result in a different outcome.⁵⁷ Justice Stevens concluded that “[f]or purposes of Commerce Clause analysis, any categorical distinction between the activities of profit-making enterprises and not-for-profit entities is . . . wholly illusory,” and therefore the tax exemption violated the negative Commerce Clause.⁵⁸

(1989)).

54. *Camps Newfound*, 520 U.S. at 568. The statute gave charitable institutions incorporated in the state a general exemption from paying real estate and personal property taxes. *Id.* However, if the charitable institution was run for the benefit of out-of-state residents, the tax benefit was much more limited. *Id.* The Petitioner, a nonprofit camp at which only five percent of the campers were from Maine, challenged the statute on the grounds that it violated the negative Commerce Clause. *Id.* at 567.

55. *Id.* at 572. The Court noted that “[t]here is no question that were this statute targeted at profit-making entities, it would violate the dormant Commerce Clause.” *Id.* at 575.

56. *Id.* at 579. The Court spent some time explaining that the fact that the in-state charitable institution, rather than the out-of-state camper, felt the brunt of the discriminatory taxation scheme was irrelevant. *Id.* at 580. At least in part, the campers would be responsible for the lack of a tax exemption, perhaps through increased costs. *Id.* Further, the Court likened the Maine camps to the natural resources of any state. *Id.* at 576–77 (“We have ‘consistently . . . held that the Commerce Clause . . . precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to the products derived therefrom.’” (quoting *New England Power Co. v. New Hampshire*, 455 U.S. 331, 338 (1982))).

57. *Id.* at 583. The Court quickly stated that the fact that an entity is not-for-profit should not change the negative Commerce Clause analysis. *Id.* at 584; see *NLRB v. Yeshiva Univ.*, 444 U.S. 672, 681 n.11 (1980) (“Congress appears to have agreed that nonprofit institutions ‘affect commerce’ under modern economic conditions.”). The Town made the argument that the tax break was effectively a government subsidy and that the government was choosing to purchase services from those camps which served Maine residents. *Camps Newfound*, 520 U.S. at 588–89. Justice Scalia, writing for the dissent, agreed with this view, stating that the tax exemption was merely a way for the state to save money by encouraging camps to provide services that Maine might ordinarily provide. *Id.* at 598 (Scalia, J., dissenting) (“[T]he provision at issue here is a narrow tax exemption, designed merely to compensate or subsidize those organizations that contribute to the public fisc by dispensing public benefits the State might otherwise provide.”). As Justice Scalia noted, the statute did not provide tax exemptions to non-profit institutions that served Maine residents, but rather to non-profit *charitable* institutions that provided a substantial public benefit. *Id.* at 599.

58. *Camps Newfound*, 520 U.S. at 586 (majority opinion). Justice Scalia continued to promote judicial restraint. *Id.* at 596 (Scalia, J., dissenting). In a preview of Justice Souter’s dissent in *Carbone* and of the Court’s opinion ten years later in *United Haulers*, Justice Scalia advanced the notion that the Commerce Clause should not be used “‘to cut the States off from legislating on all subjects relating to the health, life, and safety of their citizens, though the legislation might indirectly

Finally, central to an understanding of *Davis* is the Court's recent decision in *United Haulers* where the importance of a public-private distinction in negative Commerce Clause jurisprudence gained more traction.⁵⁹ Solid waste management companies sued a government-created waste authority to enjoin a "flow control" ordinance that required that all solid waste be delivered to a public authority's processing center.⁶⁰ The Court stated that this case was categorically different from *C & A Carbone, Inc. v. Clarkstown*,⁶¹ a recent decision that overturned a similar "flow control" ordinance, because the benefited party here was a public entity, while in *Carbone* the benefited party was a private entity.⁶² In his dissent to

affect the commerce of the country." *Id.* (quoting *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 443-44 (1960)).

59. See *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786 (2007).

60. *Id.* at 1791. During the 1980's, New York's Oneida and Herkimer counties experienced a "solid waste crisis" and requested that the state create a central solid waste management authority to run the counties' waste programs. *Id.* The state created a public benefit corporation ("Authority") which in turn created facilities for the disposal and processing of waste materials. *Id.* In order to cover the cost of the operations, the Authority decided to make the use of its facilities by all private haulers mandatory by enacting a so-called "flow control" ordinance. *Id.* The Authority charged a higher fee for its services than a company might get on the private market, in part because the Authority "offered" enhanced recycling services. *Id.* *United Haulers Association, Inc.* sued the Authority and claimed that the flow control ordinance was a violation of the negative Commerce Clause. *Id.* at 1792. The haulers would have saved a significant amount in fees if they had been allowed to use an out-of-state facility. *Id.*

61. 511 U.S. 383 (1994).

62. *United Haulers*, 127 S. Ct. at 1790. In *C & A Carbone, Inc. v. Clarkstown*, 511 U.S. at 386, the Court considered a flow control ordinance which dictated that all solid waste had to be deposited in a private facility. The arrangement was advantageous for the city of Clarkstown because the private company agreed to sell its new waste facility to the city after a set number of years for one dollar if the city agreed to create the ordinance mandating that all solid waste be deposited at the facility. *Id.* at 387. The Court in *Carbone* struck down the mandate because it facially discriminated against interstate commerce. *Id.* at 392. There was disagreement in *Carbone* as to whether or not the facility was actually a private facility. *Id.* at 419 (Souter, J., dissenting). Chief Justice Roberts, writing for the Court in *United Haulers*, stated that "[t]he *Carbone* dissent offered a number of reasons why public entities should be treated differently from private ones under the dormant Commerce Clause. It is hard to suppose that the *Carbone* majority definitively rejected these arguments without explaining why." *United Haulers*, 127 S. Ct. at 1794 (citation omitted). Chief Justice Roberts further opined that "*Carbone* cannot be regarded as having decided the public-private question," because, "[i]f the Court were extending this line of local processing cases to cover discrimination in favor of local government, one would expect it to have said so." *Id.* at 1794-95. In holding that public entities are to be treated differently than private entities for the purpose of a negative Commerce Clause discrimination analysis, Chief Justice Roberts noted the importance of government being able to "protect[] the health, safety, and welfare of its citizens," thereby making government entirely different from private enterprise. *Id.* at 1795. The Chief Justice went on to argue in favor of federalism, stating that "[t]he dormant Commerce Clause is not a roving license for federal courts to decide what activities are appropriate for state and local government to undertake,

Carbone, Justice Souter laid the groundwork for *United Haulers* by offering a number of reasons why Commerce Clause jurisprudence with regard to laws benefiting public facilities should be treated differently from laws benefiting private facilities.⁶³ The Court in *United Haulers* largely adopted Justice Souter’s reasoning and held that, because the “flow control” ordinance benefited a government entity rather than a private business, there was no violation of the negative Commerce Clause.⁶⁴

III. FACTS

The Commonwealth of Kentucky exempts income derived from its own state-issued bonds from state income tax collection while still taxing income derived from bonds originating in other states.⁶⁵ George and Catherine

and what activities must be the province of private market competition.” *Id.* at 1796. Further, the Court went on to note that waste disposal is a traditional government function, making the case against intervention even stronger, and that if the people of the state did not like the laws, they could change their elected representatives. *Id.* at 1796–97.

63. *Carbone*, 511 U.S. at 419–22 (Souter, J., dissenting). Justice Souter, joined by Chief Justice Rehnquist and Justice Blackmun in dissent, suggested that “favoring state-sponsored facilities differs from discriminating among private economic actors, and is much less likely to be protectionist.” *Id.* at 421. He noted that the government is very different from the private market and has the responsibility to engage in activity for the public good; therefore, a government’s actions should not be equated with economic protectionism. *Id.* The dissent suggested that the town of Clarkstown had an obligation to build a new waste facility, and that the passage of the flow control ordinance was the most effective means to fulfill the need. *Id.* at 420. Finally, Justice Souter reasoned that “a law that favors that single [municipal] facility over all others is a law that favors the public sector over all private-sector processors” and should therefore pass negative Commerce Clause scrutiny. *Id.* at 422.

64. *United Haulers*, 127 S. Ct. at 1797. Foreshadowing the dissent in *Davis*, Justice Alito wrote a strong dissent. *Id.* at 1803 (Alito, J., dissenting). Justice Alito argued that the facts in *United Haulers* were essentially indistinguishable from the facts in *Carbone*, and that “[t]he public–private distinction drawn by the Court is both illusory and without precedent.” *Id.* at 1804. In fact, Justice Alito stated that just the opposite is true, in that “[t]his Court long ago recognized that the Commerce Clause can be violated by a law that discriminates in favor of a state-owned monopoly.” *Id.* at 1806. For support, Justice Alito drew on a case over 100 years old, *Scott v. Donald*, in which the Court invalidated a South Carolina statute that gave a state agency the exclusive right to sell alcoholic beverages. *Id.* (citing *Scott v. Donald*, 165 U.S. 58 (1897)). Justice Alito conceded that some states now do have the right to run a state-owned liquor monopoly, but that the only reason is the passage of the Twenty-First Amendment. *Id.* For Justice Alito, because there was no similar federal Amendment or law authorizing states to discriminate against out-of-state waste facility providers, a law which allowed such discrimination had to be deemed a violation of the negative Commerce Clause. *Id.*

65. *Dep’t of Revenue of Ky. v. Davis*, 128 S. Ct. 1801, 1805 (2008). The Kentucky law at issue, Kentucky Revenue Statute § 141.020, creates a situation in which “[i]nterest on bonds issued by Kentucky and its political subdivisions is thus entirely exempt, whereas interest on municipal bonds of other States and their subdivisions is taxable.” *Id.* (footnote omitted). Interestingly, the United States Tax Code provides for the exclusion of all gains derived from state or municipal bonds when calculating gross income, effectively making the income entirely tax free, regardless of the state of origin, at the national level. See I.R.C. § 103(a) (2006). Specifically, the Code states that “gross income does not include interest on any State or local bond.” *Id.* For more on why a state finds such a differential taxation scheme preferable, see *supra* notes 4–6 and accompanying text.

Davis are Kentucky residents who owned out-of-state municipal bonds.⁶⁶ Pursuant to Kentucky revenue statutes, the interest income from these out-of-state bonds was included in the Davises' gross income for Kentucky state tax purposes and, consequently, they were taxed on their gains.⁶⁷

The Davises originally filed a class action complaint against Kentucky's tax collectors, claiming that the differential taxation scheme violated both the Commerce Clause of the United States Constitution and the Equal Protection Clause of the Fourteenth Amendment to the Constitution.⁶⁸ After failing on both theories,⁶⁹ the Davises appealed to the Court of Appeals of Kentucky.⁷⁰ The Court of Appeals of Kentucky reversed the lower court, finding that the differential taxation scheme violated the negative Commerce Clause because it was facially discriminatory and did not fall under an exception to the United States Supreme Court's negative Commerce Clause jurisprudence.⁷¹ After the Supreme Court of Kentucky declined an

66. *Davis*, 128 S. Ct. at 1807.

67. *Id.*

68. *Davis v. Dep't of Revenue of the Fin. and Admin. Cabinet*, 197 S.W.3d 557, 560 (Ky. Ct. App. 2006), *rev'd*, 128 S. Ct. 1801 (2008).

69. *Id.* at 560–61. In finding the provision constitutional, the state trial court apparently relied on the market participant exception to the negative Commerce Clause. *See Davis*, 128 S. Ct. at 1807; *see also supra* notes 42–49 and accompanying text. Kentucky's Jefferson Circuit Court also found that the Davises lacked standing to challenge the statute on behalf of others who had not yet joined the class, and granted summary judgment. *Davis*, 197 S.W.3d at 560–61. However, as the Court of Appeals of Kentucky noted, the trial court did find that the Davises had standing to contest their own alleged injury because they had already paid income tax on the bonds. *Id.* at 565. The confusion over standing likely resulted from the fact that the Department of Revenue of Kentucky brought the motion for summary judgment before the Davises had the opportunity to seek certification of the class. *Id.* at 560.

70. *Davis*, 197 S.W.3d at 561.

71. *Id.* at 564. Judge Minton, writing for a three-member panel for the Court of Appeals of Kentucky, began his analysis by stating “[c]learly, 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.” *Id.* at 562. In contrast, the state tried to rely on *Shaper v. Tracy*, a 1994 case from the Court of Appeals of Ohio, where the Ohio court found a nearly identical differential taxation scheme to be constitutionally permissible, in part because “[t]he instant action d[id] not involve a taxation scheme whereby the citizenry of Ohio are provided with a competitive advantage over the citizenry of other states. Rather, the taxation scheme in the instant action benefit[ed] the state of Ohio itself.” *Shaper v. Tracy*, 647 N.E.2d 550, 553–54 (Ohio Ct. App. 1994) (holding that “[g]iven the lack of any precedent to apply the Commerce Clause to this type of taxation scheme, we are unable to find [the statute] unconstitutional as violative of the Commerce Clause”). After admitting that *Shaper* was the only case on all fours with the instant action, Judge Minton resoundingly dismissed the state of Kentucky’s reliance on *Shaper* by concluding that “that [Ohio] court failed fully to analyze the issue.” *Davis*, 197 S.W.3d at 563. Having already found that the statute discriminated against interstate commerce, Judge Minton held that the taxation scheme could not be saved by the market participant doctrine because the state was not acting as a market participant when it made taxing decisions. *Id.* at 564. Justice Kennedy echoed this sentiment in his

opportunity to review the case, the United States Supreme Court granted certiorari, partly “because the result reached [in the Kentucky state court] casts constitutional doubt on a tax regime adopted by a majority of the States.”⁷²

IV. ANALYSIS OF THE COURT’S OPINION

A. Justice Souter’s Majority Opinion

Justice Souter began the majority opinion⁷³ by outlining Kentucky’s differential taxation scheme⁷⁴ and discussing the importance of the tax-free bonds to the states as a source of revenue.⁷⁵ In addition, Justice Souter noted

dissent in *Davis* when he argued that Kentucky could not be a market participant because “[t]he challenged state activity is differential taxation, not bond issuance.” *Davis*, 128 S. Ct. at 1825 (Kennedy, J., dissenting); see *infra* notes 142–147 and accompanying text.

72. *Davis*, 128 S. Ct. at 1808.

73. Justice Souter, writing for the Court, was joined by Justices Stevens and Breyer in full, by Chief Justice Roberts and Justice Ginsburg as to all parts except Part III-B (explaining the application of the market participant doctrine), and by Justice Scalia as to all parts except for Parts III-B and IV (discussing the application of *Pike* balancing). *Id.* at 1804.

74. *Id.* at 1804–05. Under Kentucky law, residents are taxed based upon their total net income. KY. REV. STAT. ANN. § 141.020(1) (West 2006); *Davis*, 128 S. Ct. at 1804. The state adopted the Internal Revenue Service’s definition of “gross income” as its own. *Id.*; see I.R.C. § 61(a) (2006) (“[G]ross income means all income from whatever source derived.”). Therefore, because the Internal Revenue Code does not include interest income derived from state or local bonds, the state of Kentucky generally does not either. I.R.C. § 103(a) (“[G]ross income does not include interest on any State or local bond.”); *Davis*, 128 S. Ct. at 1804–05. However, Kentucky added to its own definition of gross income by including “interest income derived from obligations of sister states and political subdivisions thereof,” in the adjusted gross income of Kentucky state taxpayers. *Id.* at 1805 (quoting § 141.010(10)(c)). The net effect is that while interest income earned on bonds issued by Kentucky and its political subdivisions remains excluded from Kentucky state income tax, interest income on bonds issued by all other states and their political subdivisions is included in Kentucky residents’ gross income and is therefore taxable at the state level. *Davis*, 128 S. Ct. at 1805.

75. *Davis*, 128 S. Ct. at 1806. Justice Souter noted that during just a six year period, from 1996 to 2002, “Kentucky and its subdivisions issued \$7.7 billion in long-term bonds to pay for spending on transportation, public safety, education, utilities, and environmental protection, among other things.” *Id.* Of the \$7.7 billion of bonds issued in Kentucky, nearly \$2 billion went toward helping the state meet its education expenses. See Cynthia Belmonte, IRS, *Tax Exempt Bonds, 1996-2002*, Summer 2005 Statistics of Income Bulletin 151, 169, available at <http://irs.gov/pub/irs-soi/02govbnd.pdf> (last visited Oct. 15, 2009). Nationwide during this same period, a total of \$2.1 trillion in tax-exempt bonds was issued by the States and their subdivisions. *Id.* at 151. Interestingly, of this \$2.1 trillion, \$548 billion in bonds was issued as private activity bonds. *Id.* Unlike regular government bonds, private activity bonds are utilized by a private entity to help finance projects which generally have some sort of public use. *Id.* at 152 (“The major types of exempt facility bonds are bonds issued for airports; docks and wharves; sewage facilities; solid waste disposal facilities; qualified residential rental projects; and facilities for the local furnishing of electricity or gas.”). Other organizations that benefit from private activity bonds include IRC § 501(c)(3) tax-exempt organizations such as “hospitals, universities, and organizations that provide low-income housing or assisted living facilities.” *Id.* One of the amici for the Davises argued that even if the Court found the issuance of bonds for governmental purposes to be valid, the Court

that the historical practice of states issuing untaxed municipal bonds had gone on since 1919.⁷⁶ After reciting the relevant facts of the case⁷⁷ and the

should still strike down the preferential treatment for in-state private activity bonds. See Brief for Alan D. Viard et al. as *Amici Curiae* Supporting Respondents at 26, Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801 (2008) (No. 06-666), 2007 WL 2808465 (arguing that “[w]ith private-activity bonds, however, private parties are the actual borrowers, not state or local governments. The *United Haulers* exception should not apply in any event to this segment of the municipal bond market.”). Justice Souter declined to discuss this argument in detail, noting that the Davises themselves had not bothered to advance the argument and that it had not been considered by the court below. *Davis*, 128 S. Ct. at 1805 n.2. Instead of considering it as part of *Davis*, the majority preferred to “set this argument aside and leave for another day any claim that differential treatment of interest on private-activity bonds should be evaluated differently from the treatment of municipal bond interest generally.” *Id.* During oral arguments Justice Alito raised the difference between bonds which benefit the government generally and bonds which benefit a private entity. See Transcript of Oral Argument of C. Christopher Trower on Behalf of Petitioners at 3–5, Dep't of Revenue of Ky. v. Davis, 128 S. Ct. 1801 (2008) (No. 06-666), 2007 WL 3248725. As part of this discussion, Justice Souter asked, “Doesn’t that raise, in effect, sort of a distinction between *Carbone* and *United Haulers*? Or at least one way of understanding the distinction between those two cases? In *Carbone* the facility, in fact, was not the facility of the government.” *Id.* at 4–5. Justice Souter was referring to the fact that in *Carbone*, a majority of the Court struck down a flow control ordinance which benefited a private waste facility, even though the city would be benefited tangentially from the regulation. See *C & A Carbone, Inc. v. Clarkstown*, 511 U.S. 383, 392 (1994); see *supra* notes 62–63 and accompanying text. The dissent in *Davis* also declined to discuss private activity bonds, perhaps because the majority refused to consider them. *Davis*, 128 S. Ct. at 1822–30. However, if the Court were to consider the preferential tax treatment of private activity bonds in the future, it would be unlikely to find such a differential taxation scheme constitutional given the distinction the Court previously drew between *Carbone* and *United Haulers*. In order to find private activity bonds constitutional, the Court would either have to dismiss precedent in *Carbone* or find a way to carve out a distinction for private activity bonds by arguing that their issuance directly benefits states and their subsidiaries. Commentators have already suggested that the Court’s inability to address private activity bonds in *Davis* will lead to continuing uncertainty in the municipal bond market. *Dormant Commerce Clause*, *supra* note 11, at 277 (“[T]he *Davis* ruling is only a hollow victory for [the municipal bond market] because it does not rule on the tax treatment of an important form of municipal debt issuance—private activity bonds. Until the Court is presented with a case that enables it to rule on the tax treatment of private activity bonds, uncertainty on this issue will continue to affect the municipal bond market.”). For a more in-depth discussion of the possibility that private activity bonds will eventually be found to violate the negative Commerce Clause, see *infra* notes 174–177 and accompanying text.

76. *Davis*, 128 S. Ct. at 1806. Differential bond taxation schemes have been common since the early part of the twentieth century. *Id.* In 1919, New York became the first state to create a favorable tax scheme for its own bonds, and the Commonwealth of Kentucky followed suit in 1936. *Id.* The fact that states soon followed New York in creating discriminatory taxation schemes is exactly the kind of evidence that Justice Kennedy would use in arguing for the application of the negative Commerce Clause. Indeed, he underscored this very point in his dissent when he noted that the fact “[t]hat 41 States have local protectionist laws similar to this one proves the necessity of allowing settled principles against discrimination to operate in an important national market” and went on to chastise the Court for being “proud” in pointing out that New York was the first state to implement the taxation plan. *Id.* at 1829 (Kennedy, J., dissenting).

77. For more on the facts, see *supra* notes 65–72 and accompanying text.

procedural history of the case in the lower courts,⁷⁸ Justice Souter noted that the Court granted certiorari to resolve an important issue of constitutional law.⁷⁹

Justice Souter next progressed through a standard negative Commerce Clause rule statement.⁸⁰ However, in laying out the Court's negative Commerce Clause jurisprudence, Justice Souter emphasized the federalist principles which seemingly contradict the negative Commerce Clause, something that not even Chief Justice Roberts did in *United Haulers*.⁸¹

78. See *supra* notes 69–72 and accompanying text.

79. *Davis*, 128 S. Ct. at 1808.

80. *Id.* Justice Souter noted that the negative Commerce Clause was derived out of Congress's Commerce Clause powers as a way to protect against economic protectionism and ensure that states did not become Balkanized. *Id.*; see *supra* notes 29–32 and accompanying text. If a law is viewed as discriminatory for economic protectionist reasons, it will usually be automatically invalidated. *Davis*, 128 S. Ct. at 1808. However, the law can be saved "if it 'advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.'" *Id.* (quoting *Or. Waste Sys., Inc. v. Dep't of Env'tl. Quality of Or.*, 511 U.S. 93, 101 (1994)). If there is no discrimination for economic protectionist reasons, the Court applies *Pike* balancing and attempts to discern whether the burden on interstate commerce outweighs the benefits to the state. *Id.* Finally, in some cases, a state's law will be saved if the state is found to be an active market participant rather than a market regulator. *Id.* at 1809.

81. *Davis*, 128 S. Ct. at 1808. In *United Haulers*, Chief Justice Roberts provided a much more streamlined rule statement and made no mention of federalist principles. *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1792–93 (2007). Conversely, in *Davis*, Justice Souter argued that "the Framers' distrust of economic Balkanization was limited by their federalism favoring a degree of local autonomy." *Davis*, 128 S. Ct. at 1808 (citing THE FEDERALIST NOS. 7, 11 (Alexander Hamilton), NOS. 42, 51 (James Madison) (George W. Carey & James McClellan eds., Liberty Fund, Inc. 2001) (1787)). The discussion of the importance of both unity in commerce and of federalism by Alexander Hamilton and James Madison provides important insight in understanding how the founders viewed the Constitution. Alexander Hamilton wrote about the problems unfettered commerce between the states might cause when he noted:

The competitions of commerce would be another fruitful source of contention. The states less favourably circumstanced, would be desirous of escaping from the disadvantages of local situation, and of sharing in the advantages of their more fortunate neighbours. Each state, or separate confederacy, would pursue a system of commercial polity peculiar to itself. This would occasion distinctions, preferences, and exclusions, which would beget discontent.

THE FEDERALIST NO. 7, at 28–29 (Alexander Hamilton). In another paper, Hamilton argued that the colonies must remain united commercially so as to prevent European domination of the young country. THE FEDERALIST NO. 11, at 49–55 (Alexander Hamilton). Hamilton noted that "[b]y prohibitory regulations, extending at the same time throughout the states, we may oblige foreign countries to bid against each other, for the privileges of our markets." *Id.* at 50. Indeed, Hamilton opined that if the country did not remain united in commerce, the power of the country would be greatly diminished and the United States would devolve into an economy of "passive commerce." *Id.* at 52 (arguing that if commerce was not regulated in the United States, "[t]hat unequalled spirit of enterprise, which signalizes the genius of the American merchants and navigators, and which is in itself an inexhaustible mine of national wealth, would be stifled and lost; and poverty and disgrace would overspread a country, which, with wisdom, might make herself the admiration and envy of the world."). James Madison took up the cause to argue for Congress' ability to regulate interstate commerce in his own papers. THE FEDERALIST NO. 42 (James Madison). Madison wrote that one of the main defects in the old confederacy was that there was no central authority capable of regulating commerce among the separate states, and that if this practice were to continue, "it would

Subsequently, Justice Souter summarized *United Haulers*⁸² and began his analysis with the simple, yet bold, statement that “[i]t follows *a fortiori* from *United Haulers* that Kentucky must prevail.”⁸³ The rationale was straightforward in that, because the state of Kentucky was fulfilling the traditional government function of raising revenue through the issuance of bonds, the manner in which it chose to do so could not be circumscribed by the negative Commerce Clause so long as all private entities were treated the same.⁸⁴ Justice Souter continued to develop the public–private distinction

nourish unceasing animosities, and not improbably terminate in serious interruptions of the public tranquillity.” *Id.* at 218–19. However, against this backdrop in which Hamilton and Madison explained why it was important that the states not be allowed to discriminate against one another in commerce, Madison also argued that federalism was the answer to many of the problems of the old confederacy. THE FEDERALIST NO. 51 (James Madison). Madison stated that the challenge of creating a government was that “[one] must first enable the government to control the governed; and in the next place oblige it to control itself.” *Id.* at 269. The solution to the problem of an all-powerful central government was to divide power between multiple governments and then divide the power within each government into several smaller parts. *Id.* at 270 (“In the compound republic of America, the power surrendered by the people, is first divided between two distinct governments, and then the portion allotted to each subdivided among distinct and separate departments.”). On the whole, Hamilton and Madison certainly argue for the importance of a unified national system of commerce, yet they also speak to the importance of a federal system in which the powers of government remain divided and no one government hoards all of the power. The dissenters in *Davis* seem to agree wholeheartedly with the admonitions in *The Federalist Nos. 7, 11 and 42*, but do not speak much to the importance that the majority implicitly lends to James Madison’s argument in *The Federalist No. 51* with respect to federalism. See *Davis*, 128 S. Ct. at 1822 (Kennedy, J., dissenting). Justice Kennedy noted that “[f]ree trade in the United States, unobstructed by state and local barriers, was indispensable if we were to unite to ensure the liberty and progress of the whole Nation and its people.” *Id.* Justice Kennedy went on to note that historically the nation has benefited as result of general unity in commerce. *Id.*

82. *Davis*, 128 S. Ct. at 1809 (majority opinion). The points which Justice Souter chose to emphasize effectively foreshadow his analysis. He noted that, as the Court found in *United Haulers*, states have a duty to provide goods and services for their citizens and there are good reasons to treat laws which favor states and municipalities differently than laws which favor private enterprise. See *id.* He further stressed that in *United Haulers*, the supposed harm that developed from the statute—more expensive trash removal—was a burden which would be borne by the very people (in-state residents) who elected the representatives that enacted the laws in the first place. *Id.* He closed by again noting the federalist underpinnings which guided the Court’s decision in *United Haulers*. *Id.* at 1809–10 (“Being concerned that a ‘contrary approach . . . would lead to unprecedented and unbounded interference by the courts with state and local government,’ . . . we held that the ordinance did ‘not discriminate against interstate commerce for purposes of the dormant Commerce Clause.’” (quoting *United Haulers*, 127 S. Ct. at 1795–96) (citation omitted)).

83. *Id.* at 1810. Justice Souter argued that *United Haulers* stands for the proposition that the negative Commerce Clause analysis should not be applied to traditional government functions. *Id.* He noted that the issuance of bonds to pay for the needs of the public “is a quintessentially public function” and seemed to intimate that the government function of raising revenue to pay for projects is an even more traditional government function than providing for waste removal. *Id.* at 1810–11.

84. *Id.* Justice Kennedy strongly attacked the majority’s analysis on this point. *Id.* at 1824 (Kennedy, J., dissenting). He noted that Justice Souter merely reformulated the police power when

by referencing *Bonaparte v. Tax Court*, an 1882 case in which the Supreme Court held that when state-issued bonds travel out of their state of origin, they lose their public character and become part of the private market.⁸⁵ The majority then returned to *United Haulers*, arguing that, like New York's statute in *United Haulers*, the Kentucky tax scheme benefited only the public entity of the state and treated all private entities, both in-state and out, exactly the same.⁸⁶

Having already decided that “[t]his type of law does ‘not “discriminate against interstate commerce” for purposes of the [negative] Commerce Clause,’”⁸⁷ Justice Souter next applied the market participant doctrine in Part

he referred to a state's traditional government functions, which did not immunize it from constitutional limitations. *Id.* (“That a law has the police power label—as all laws do—does not exempt it from Commerce Clause analysis.”). According to Justice Kennedy, if the majority analysis were to be adopted, any government function could be restated as a police power, and state laws regarding that government function would therefore receive immunity from negative Commerce Clause scrutiny. *Id.* Justice Souter responded by suggesting that the dissenters did not entirely understand his message in *United Haulers*. *Id.* at 1810 n.9 (majority opinion) (“The point of asking whether the challenged governmental preference operated to support a traditional public function was not to draw fine distinctions among governmental functions, but to find out whether the preference was for the benefit of a government fulfilling governmental obligations or for the benefit of private interests, favored because they were local.”).

85. *Id.* at 1811 (citing *Bonaparte v. Tax Court*, 104 U.S. 592, 595 (1882)). In *Bonaparte*, the Court considered the complaint of Baltimore resident Mrs. Elizabeth Patterson, who was forced to pay Maryland tax on the out-of-state bonds she owned. *Bonaparte*, 104 U.S. at 592. Mrs. Patterson owned securities issued by New York, Pennsylvania, Ohio, and the City of Philadelphia. *Id.* All of the public debt she owned was exempted from taxation in each security's respective home state. *Id.* However, the State of Maryland refused to acknowledge the tax exemptions and taxed her gains. *Id.* Chief Justice Waite, delivering the opinion of the Court, stated that “[w]e know of no provision of the Constitution of the United States which prohibits such taxation,” and “[t]he only agreement as to taxation was that the debt should not be taxed by the State which created it.” *Id.* at 594. More importantly, at least for Justice Souter's purposes in *Davis*, Chief Justice Waite next spoke to the character of the bonds themselves. He noted that once the debt moves out of the state of origin, “[t]he debtor State is in no respect his sovereign, neither has it any of the attributes of sovereignty as to the debt it owes.” *Id.* at 595. Finally, the Chief Justice seemed to condone the very sort of differential taxation at issue in this case when he wrote that while a state can exclude its own debts from taxation within its own borders, it does not have the ability to prevent taxation of its debt outside its border. *Id.* at 595 (“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.” (emphasis added)).

86. *Davis*, 128 S. Ct. at 1811. The dissent refused to acknowledge the public-private distinction and blasted the Court by saying that throughout history, with the exception of *United Haulers*, “the Court had ceased to view the concept as saying anything instructive.” *Id.* at 1824 (Kennedy, J., dissenting). Justice Souter seemingly mocked the dissent's resistance to submit to the Court's holding in *United Haulers* by simply stating that “the dissenters thus carry on the battle that was fought in *United Haulers*.” *Id.* at 1810 n.9 (majority opinion) (“One of the two fundamental points of difference between the Court and the dissenters is their rejection of the constitutional distinction between public and private preference . . .”).

87. *Id.* at 1811 (quoting *United Haulers*, 127 S. Ct. at 1797). The majority held that there was no discrimination in this case simply “because [the state], as a public entity, does not have to treat itself as being ‘substantially similar’ to the other bond issuers in the market.” *Id.*

III-B of his opinion.⁸⁸ He started by rejecting the Davises' argument that the ultimate issue in this case was the differential taxation of the bonds; the real concern, according to Justice Souter, was that the state issued the bonds in the first place.⁸⁹ Justice Souter found that the tax could not be bifurcated from the issuance of the bonds because "there is no ignoring the fact that imposing the differential tax scheme makes sense only because Kentucky is

88. *Id.* A majority of the Court did not join Justice Souter's discussion of the market participant doctrine. *Id.* at 1802. Chief Justice Roberts stated that, in his view, "the case is readily resolved by last Term's decision in *United Haulers*," and therefore there was no need to consider the market participation doctrine. *Id.* at 1821 (Roberts, C.J., concurring in part). Likewise, Justice Scalia chose not to join Justice Souter's market participation analysis because "Part III-A adequately resolves the issue." *Id.* at 1821 (Scalia, J., concurring in part). Justice Thomas, flatly rejecting the existence of the negative Commerce Clause as a sound part of the Court's jurisprudence, also declined to join Justice Souter in applying the market participation doctrine. *Id.* at 1821–22 (Thomas, J., concurring in judgment). Justice Kennedy did not let this lack of unity go unnoticed and he seemed gleeful that only a single part of Justice Souter's opinion actually garnered a majority of the Court. *Id.* at 1827 (Kennedy, J., dissenting). Unfortunately for Justice Kennedy, it was the most important part—the application of the civic responsibility exception—in which Justice Souter secured a majority.

89. *Id.* at 1811–12 (majority opinion). Again, the dissent continued to voice its disagreement with Justice Souter's analysis, warning that the true issue in the case was Kentucky's taxation of the bonds, rather than the issuance of them. *Id.* at 1825 (Kennedy, J., dissenting) ("The challenged state activity is differential taxation, not bond issuance. The state tax provision at issue could be repealed tomorrow without altering or impairing a single obligation in the bonds."). The majority saw the issue as one of public finance in which bond issuance and taxation were two integral parts of a singular whole. *Id.* The distinction is key to the outcome of the case, because Justice Souter seemed to admit that, were the case simply about Kentucky using its taxing authority, negative Commerce Clause scrutiny would probably be appropriate. *Id.* at 1812. (plurality opinion). The Court has previously invalidated a number of taxing schemes because of discrimination against interstate commerce. See *supra* note 50. Justice Souter specifically cited a number of these cases. In one, *Camps Newfound*, the Court considered a Maine statute which gave a tax exemption to charitable organizations, so long as those charitable organizations operated for the benefit of residents of Maine. *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 568 (1997). Although Justice Souter did not note the difference between *Camps Newfound* and *Davis*, the difference is clear—the tax statute in *Camps Newfound* existed in order to benefit private organizations, whereas the tax statute in *Davis* existed in order to benefit public entities in the form of the state or municipalities. The distinction holds in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996). In that case, the Court considered a North Carolina statute which set the tax rate on corporate stock at an inverse proportion to the amount of business a company did in North Carolina. *Fulton*, 516 U.S. at 327–28. North Carolina did not act for its own good, but merely penalized both private companies who conducted relatively little business in the state and the private citizens who owned those companies' securities. *Id.* Finally, in *Bacchus Imports, Ltd. v. Dias*, the Court considered and struck down a Hawaii statute which imposed a twenty percent excise tax on liquor generally, but excepted some liquors which were produced locally. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 265 (1984). Again, the beneficiaries of the tax were private producers, not the state itself. See *id.* at 269. It is clear that while the Court has consistently ruled that taxes that favor private entities run afoul of the negative Commerce Clause, the Court has never held that a tax benefiting a public entity does the same.

also a bond issuer.”⁹⁰ To Justice Souter, the fact that Kentucky was a participant in the very market it regulated meant that the regulation could not be seen as discriminatory under the traditional negative Commerce Clause analysis.⁹¹ In many prior cases, the Court upheld regulations which would have violated the negative Commerce Clause had they benefited a private interest instead of the state or a similar public entity.⁹² Justice Souter went on to explain that in order to hold that the Kentucky scheme violated the negative Commerce Clause, the Court would have to effectively overrule its past market participant doctrine jurisprudence.⁹³ For Justice Souter, because

90. *Davis*, 128 S. Ct. at 1812 (plurality opinion) (“The Commonwealth has entered the market for debt securities, just as Maryland entered the market for automobile hulks . . . and South Dakota entered the cement market . . .” (citation omitted)). This supposition certainly seems logical. If the state of Kentucky and its subdivisions did not issue bonds, there would be no need for it to create a differential taxation scheme to make the bonds more attractive on the open market. Therefore, Justice Kennedy was very much right when he said that, “[i]t is the tax that matters.” *Id.* at 1825 (Kennedy, J., dissenting). However, Justice Kennedy was right that it is the tax that matters only because Kentucky issues bonds to begin with. *Id.* Without the bonds, the argument over taxation becomes irrelevant.

91. *Id.* at 1812 (plurality opinion). Professor Norman R. Williams, in a recent article on the importance of a national economic union to the United States, adopts the argument of the dissent. He suggests that this case is not about what Kentucky is selling; rather, it is about “Kentucky . . . taxing bonds sold by other states to Kentucky taxpayers.” Norman R. Williams, *The Foundations of the American Common Market*, 84 NOTRE DAME L. REV. 409, 458 n.187 (2008). Professor Williams suggests that “Kentucky is not purchasing or selling any item; it has not, for example, decided to sell its bonds only to Kentucky citizens, a policy that might arguably qualify as within the exception.” *Id.* This argument is again in line with the dissenters’ seemingly ceaseless contention that taxing “is a quintessential act of regulation, not market participation.” *Davis*, 128 S. Ct. at 1829 (Kennedy, J., dissenting). Both Professor Williams and the dissent in *Davis* cite to *New Energy* for authority that taxation is a regulatory function, not a market activity. *Id.* at 1829–30; Williams, *supra* at 458 n.187. This case, of course, is very different than *New Energy*. *New Energy* dealt with a tax credit which Ohio provided to in-state fuel dealers and those out-of-state fuel dealers who came from states with reciprocal agreements. *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 271–72 (1988); see *supra* notes 51–53 and accompanying text. *Davis*, once again, is completely antithetical to *New Energy* because in the former, the tax scheme existed for the purpose of furthering a public financing scheme, not for the benefit of a private business entity.

92. *Davis*, 128 S. Ct. at 1813–14. Professor Blumstein noted three decades ago that, while the Court routinely strikes down taxes which burden out-of-state businesses, there may be a difference in analysis when the government is the beneficiary of a taxing scheme. He wrote that:

Of course, what makes the matter interesting at the outset is that the disparity in tax treatment of out-of-state tax-exempt securities results from differential treatment when the ostensible beneficiary is the state itself or a sub-unit of local government. The other tax cases, in which the Court “has seldom hesitated to strike down statutes discriminatory on their face,” involved tax disadvantages for out-of-state businesses that were competing with local enterprise. Given *Hughes*, and to a lesser extent *Usery*, one must at least stop to inquire whether this distinction does or should make a difference analytically.

James F. Blumstein, *Some Intersections of the Negative Commerce Clause and the New Federalism: The Case of Discriminatory State Income Tax Treatment of Out-of-State Tax-Exempt Bonds*, 31 VAND. L. REV. 473, 565–66 (1978) (quoting Note, *Developments in the Law—Federal Limitations on State Taxation of Interstate Business*, 75 HARV. L. REV. 953, 962 n.44 (1962)) (footnote omitted).

93. *Davis*, 128 S. Ct. at 1813. (plurality opinion). Justice Souter cited to *Alexandria Scrap* as an example of a case which would have to be overruled in order to hold that Kentucky was not a market

the state acted as a regulator in order to further its involvement in the market, the differential taxation scheme fit squarely within the market participant exemption.⁹⁴

In Part III-C, Justice Souter, again delivering the opinion of the Court, discussed the market that the tax exemption affects.⁹⁵ First, the market at its broadest includes the “issuers and holders of all fixed-income securities, whatever their source or ultimate destination.”⁹⁶ With regard to this market, Justice Souter noted that there is no preference given to local issuers of bonds, and thus, no discrimination under the negative Commerce Clause.⁹⁷ The narrower market of municipal bond funds was next identified as all federally tax-exempt municipal bonds.⁹⁸ While here, “the distinction

participant. *Id.* He suggested that the state can act in the dual roles of a regulator *and* a market participant and still fall within the rubric of the market participation doctrine. *Id.* Such a theory might be called a dual purpose theory and could more properly be seen as a subset of the broader market participation doctrine. In any event, Justice Souter stated that in *Alexandria Scrap*, the State of Maryland essentially entered the market for hulks when it attempted to “bid up [the] price” in order to encourage the more efficient disposal of the automobile relics. *Id.* (quoting *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806 (1976)). He also argued that the scheme was regulatory in nature, like the tax here, but the fact that Maryland also acted as a market participant was enough for the Court in *Alexandria Scrap* to find that the Maryland statute did not violate the negative Commerce Clause. *Id.* Although Chief Justice Roberts did not analyze *United Haulers* under the market participation doctrine, Justice Souter was more than willing to make an argument for him retroactively in *Davis*; he suggested that *United Haulers* is another example of a state acting as both a market regulator and a market participant because there, while the public authority was acting as a market participant by processing waste, it was able to do so because of the government’s regulations that forced private haulers to bring waste to the Authority’s facility. *Id.* The regulation in *United Haulers* (the ordinance) helped the public entity perform better in the market, just like Kentucky’s regulation (the tax) helped the state improve its market performance.

94. *Id.* at 1814 (plurality opinion) (“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.”).

95. *Id.* at 1815.

96. *Id.* This is the broadest formulation of the bond market and includes all public and private issuers. *Id.*

97. *Id.* Private bonds issued within the state of Kentucky are not given the same preferential treatment that Kentucky grants itself in issuing bonds. *Id.* Therefore, Justice Souter’s argument with regard to the market as a whole is that every private entity which sells bonds is treated exactly the same under the taxation scheme.

98. *Id.* Per Internal Revenue Code § 103(a), “gross income does not include interest on any State or local bond.” I.R.C. § 103(a) (2006); *see supra* note 74. However, it should be noted that this tax exemption is a congressionally created benefit for the states and their subdivisions and that the federal government could take the benefit away at any time. The Supreme Court considered whether states have a constitutional right to be free from federal income taxation of their locally-issued debts in *South Carolina v. Baker*, 485 U.S. 505 (1988). Therein, South Carolina argued that a federal statute which required municipals bonds to be registered in order for the holder to receive a federal tax exemption was either a violation of the Tenth Amendment and federalist principles or,

between the taxing State's bonds and their holders and issuers and holders of out-of-state counterparts is at its most stark," the very fact that every state is in favor of this scheme is an indication that the tax exemption should not constitute a violation of the negative Commerce Clause.⁹⁹

The third market for municipal bonds which Justice Souter identified was the market for bonds within a single state, often consisting of single state funds.¹⁰⁰ These single state funds have the ability to absorb the bonds issued by smaller municipalities, which, as Justice Souter argued, the national market often disregards.¹⁰¹ Without the differential taxation scheme

alternatively, a violation of the doctrine of intergovernmental tax immunity. *Id.* at 507–08. The Court flatly rejected the idea that the United States lacked the power to tax municipal bonds, holding that a federal tax on municipal bonds violated neither the Tenth Amendment nor the doctrine of intergovernmental tax immunity. *Id.* at 527. However, it seems unlikely that the federal government would ever completely remove the tax exemption from the Internal Revenue Code. It has been argued that from the creation of the Sixteenth Amendment, creating the power in the federal government to tax income, it was understood that the United States would never tax the obligations of the states and their subdivisions. Maxwell A. Miller & Mark A. Glick, *The Resurgence of Federalism: The Case for Tax-Exempt Bonds*, 1 TEX. REV. L. & POL. 25, 44 (1997) ("Despite the Sixteenth Amendment's explicit language that Congress could tax income 'from whatever source derived,' assurances were given by amendment proponents that interest income on state and local obligations would be exempt." (quoting U.S. CONST. amend. XVI) (footnote omitted)).

99. *Davis*, 128 S. Ct. at 1815. In the States' brief as amici, they argued that the States' right to determine how their own debt is financed was recognized by Alexander Hamilton in *The Federalist*. Brief for the States, *supra* note 5, at 1 (citing THE FEDERALIST NO. 81 (Alexander Hamilton)). The States warned that if the differential taxation scheme were overturned, there would be "staggering potential liability," a loss in the value of bonds, and increasing costs of borrowing in the future. *Id.* at 1–2. The States also made the argument that within this discrete market, Kentucky was not similarly situated to other bond sellers because "no other bond issuer is in the business of providing public works within the State of Kentucky." *Id.* at 3. The dissent's resistance to this argument is palpable as Justice Kennedy argued that the fact that so many states have such a taxation scheme is all the more reason to invalidate them. *Davis*, 128 S. Ct. at 1829 (Kennedy, J., dissenting). Justice Kennedy did, however, admit that "[t]he concern is legitimate" that there would be a disruption in the market for bonds if differential taxation were invalidated. *Id.* at 1830.

100. *Davis*, 128 S. Ct. at 1816 (majority opinion). Large portfolios of municipal bonds are often created so that the investing public may buy into a bond fund without the small, but not insignificant, risk of investing in a single municipal bond. For example, Vanguard offers a fund intended only for California residents that is comprised of bonds issued by California municipalities. See Vanguard—California Long-Term Tax-Exempt Fund Investor Shares, <https://personal.vanguard.com/us/funds/snapshot?FundId=0075&FundIntExt=INT#hist::tab=0> (last visited Oct. 16, 2009). The Vanguard California Long-Term Tax-Exempt Fund Investor Shares included, as of September 30, 2009, \$3 billion in assets and 435 different municipal bonds. *Id.* Justice Kennedy heavily criticized the notion that Kentucky was in some sort of discrete market apart from all others when it and its subdivisions issue bonds. *Davis*, 128 S. Ct. at 1828 (Kennedy, J., dissenting). He did, however, seem to accept the notion that there is a discrete submarket for all state and municipal bonds due to Internal Revenue Code § 103(a). *Id.* It seems that while Justice Kennedy was willing to accept the legislatively created discrete market for municipal bonds on a national level, he was, for some reason, unwilling to accept the legislatively created discrete market for bonds on the state level. See *id.* Justice Kennedy can quibble over whether there *should* be a discrete market within each state for municipal bonds, but the fact remains that the market for bonds in California is very different from the market for bonds in Maine, with residents of each state naturally favoring their own bonds because of state laws exempting gains from taxation.

101. *Davis*, 128 S. Ct. at 1816 (majority opinion). The State of Iowa Insurance Division

the states employ, smaller municipalities might lose the only market—single state funds—readily willing to purchase the bonds they issue.¹⁰² Justice Souter summarized the importance of the tax scheme to the states by noting that:

In sum, the differential tax scheme is critical to the operation of an identifiable segment of the municipal financial market as it currently functions, and this fact alone demonstrates that the unanimous desire of the States to preserve the tax feature is a far cry from the private protectionism that has driven the development of the [negative] Commerce Clause.¹⁰³

highlights the problem by noting that “[m]unicipal bonds for very small projects have very small or ‘thinly traded’ resale markets. A bond from a small issue may be very hard to resell at a price close to the original purchase price.” Iowa Insurance Division, Municipal Bonds, http://www.iid.state.ia.us/investor_ed/muni.asp (last visited Oct. 16, 2009). Municipal bonds issued by smaller cities for smaller projects have much less demand on the open market due to their general lack of liquidity. *See id.* Without the single state bond funds, smaller municipalities might have serious trouble funding their city projects with debt financing. *Davis*, 128 S. Ct. at 1816.

102. *Davis*, 128 S. Ct. at 1816. Justice Souter argued that if the differential taxation scheme were invalidated, the single state funds would probably cease to exist, as their primary advantage is in the fact that they offer tax-free returns to in-state investors. *Id.* In a brief in support of neither party, the National Federation of Municipal Analysts provided great insight into the problems which would emerge if single state funds no longer existed. *See* Brief for the National Federation of Municipal Analysts, as *Amicus Curiae* In Support of Neither Party, Dep’t of Revenue of Ky. v. *Davis*, 128 S. Ct. 1801 (2008) (No. 06-666), 2007 WL 2115441. They argued that national mutual funds do not bother to look at relatively small municipal bonds since the amount of capital they must invest makes it cumbersome to research relatively tiny investment opportunities. *Id.* at 15. Single state funds, on the other hand, are more than willing to research smaller municipal bonds because single state funds’ only possible investments are state and municipal bonds. *Id.* (“Because a single state fund is required to invest substantially all of its assets in municipal bonds issued in one specific state, the analysts and portfolio managers assigned to a single state fund focus on the full spectrum of municipal bond issuers of the applicable state in a manner that analysts and portfolio managers of national mutual funds do not.”).

103. *Davis*, 128 S. Ct. at 1817. Justice Souter noted that there is no indication that the national market would be more welcoming of and interested in small municipal bonds if the tax scheme were invalidated. *Id.* at 1816. The Davises themselves argued that this market reorientation would be a good thing. Brief for Respondent in Opposition to Petition at 11 n.5, Dep’t of Revenue of Ky. v. *Davis*, 128 S. Ct. 1801 (2008) (No. 06-666), 2007 WL 128601. They noted in their brief that because municipalities would have a tougher time getting funding without the tax incentives if their claim were upheld, “[r]ather than being coerced by competing state tax codes to invest in their home states’ projects—even if those bonds are less secure or fund less beneficial projects than those sold by competing states—[investors would be able to] choose their debt investments from a wider menu.” *Id.* In this way, the Davises argued, states would be forced to create better projects and fund them more efficiently, all while proving to the marketplace that the proposed investment was sound. *Id.*

Finally, the majority opinion discussed the application of the *Pike* balancing test.¹⁰⁴ However, before discussing the balancing required under *Pike*, Justice Souter immediately questioned whether this type of case could even be resolved by *Pike*.¹⁰⁵ Leaving this question unresolved, he stated that

104. *Davis*, 128 S. Ct. at 1817. Justice Souter stated that “the courtroom door [is generally left] open to plaintiffs invoking the rule in *Pike*, that even nondiscriminatory burdens on commerce may be struck down on a showing that those burdens clearly outweigh the benefits of a state or local practice.” *Id.* *Pike* has long been a subject of criticism, inter alia, because the balancing the Court must undergo is essentially meaningless. In almost all cases where the Court has decided that a statute is not per se discriminatory, it will have trouble finding that the burden of the law outweighs the benefit. See Stanley E. Cox, *Garbage In, Garbage Out: Court Confusion About the Dormant Commerce Clause*, 50 OKLA. L. REV. 155, 170 (1997) (“The problem with the Court’s insistence that it evaluate either under a deferential *Pike* or a presumptively unconstitutional per se test is that it is not always clear which test should apply, yet the test becomes nearly determinative of the result. If the *Pike* test is used, the presumption will be that the statute should stand, until and unless the opponent can demonstrate that alternatives which burden commerce less can still accomplish the state’s goals.”). Other scholars have suggested that the Court has found it necessary to give the appearance that it engaged in a balancing approach, because otherwise “[the Court] would have to admit it was engaged in motive review, which it is obviously loath to do.” Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1285–86 (1986) (noting that “[i]f the Court is engaged in motive review but does not want to say so, balancing talk provides an ideal cover. Protectionist effect balancing, and especially weak protectionist effect balancing (with the ‘clearly excessive’ test), comes as close to mimicking motive review as any non-purpose-based test could be expected to come.”). Even if a case does reach the *Pike* stage of analysis, Justice Souter previously suggested in *General Motors Corp. v. Tracy* that the *Pike* analysis still turns on “the discriminatory character of the . . . state regulation[.]” *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 298 n.12 (1997). Another commentator suggested that the outcome of a *Pike* balancing test is so unpredictable that the analysis is analogous to chaos theory in that the outcome is subject to random chance. See James D. Fox, *State Benefits Under the Pike Balancing Test of the Dormant Commerce Clause: Putative or Actual?*, 1 AVE MARIA L. REV. 175, 177 (2003) (arguing that “attractors, or legal rules, that should produce predictable analytical paths, given a certain starting set of facts, are not clear.”).

105. *Davis*, 128 S. Ct. at 1817. The Court, according to Justice Souter, has not traditionally discussed *Pike* balancing in tandem with a market participation doctrine analysis. *Id.* He did note, however, that *United Haulers* included a *Pike* balancing analysis. *Id.* In *United Haulers*, Chief Justice Roberts flatly stated that the flow control ordinances in question should be analyzed under *Pike*. *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1797 (2007). The analysis the Chief Justice provided was bare and only reflected the Court’s opinion that the flow control ordinance was a net good. *Id.* at 1797–98. The *United Haulers* Court stated that the benefits included revenue generation and recycling, which would lead to health and environmental benefits. *Id.* at 1798. And, “[i]f the haulers could take waste to any disposal site, achieving an equal level of enforcement would be much more costly, if not impossible.” *Id.* Pursuant to this analysis, the Chief Justice concluded that there was no need “to decide whether the ordinances impose any incidental burden on interstate commerce because any arguable burden does not exceed the public benefits of the ordinances” consequently, the law was upheld. *Id.* at 1797. Justice Scalia mocked the plurality for applying *Pike*, stating that the Constitution dictated that Congress would balance the priorities of the people, not the judiciary. *Id.* at 1799 (Scalia, J., concurring in part). Chief Justice Roberts did not indicate that stare decisis was his main impetus for applying *Pike*, but it may very well be that that was the case. Elsewhere in his opinion, the Chief Justice seemed to side with Justice Scalia that the Court should not be in the business of balancing benefits and burdens. *Id.* at 1796 (majority opinion) (“It is not the office of the Commerce Clause to control the decision of the voters on whether government or the private sector should provide waste management services. ‘The Commerce Clause significantly limits the ability of States and localities to regulate or

even if *Pike* should be applied to market participant doctrine cases, “the current record and scholarly material convince us that the Judicial Branch is not institutionally suited to draw reliable conclusions” which are needed to apply *Pike*.¹⁰⁶ The Court noted that in order to apply *Pike* to this case, it would be required to undergo a cost–benefit analysis to determine whether the burden of the tax scheme outweighed the benefit.¹⁰⁷ Justice Souter indicated that while *Pike* is normally hard to apply, it is especially hard to apply given the complex subject matter at hand.¹⁰⁸ He noted that with regard

otherwise burden the flow of interstate commerce, but it does not elevate free trade above all other values.” (quoting *Maine v. Taylor*, 477 U.S. 131, 151 (1986)).

106. *Davis*, 128 S. Ct. at 1817.

107. *Id.* at 1818. The Davises suggested that the differential taxation scheme caused harm to at least five different entities: (1) out-of-state issuers; (2) out-of-state private sellers; (3) the national municipal bond market; (4) Kentucky investors; and (5) the states themselves. Brief for Respondents at 9, *Dep’t of Revenue of Kentucky v. Davis*, 128 S. Ct. 1801 (2008) (No. 06-666), 2007 WL 2808463. In response, Justice Souter noted that engaging in an analysis of the cost–benefit ratio for each affected entity “would be a very subtle exercise.” *Davis*, 128 S. Ct. at 1818. What he seemed to be saying is that such an analysis would be too complicated for the Court. Instead, he merely returned to his standby argument that all of the other states support the taxation scheme, so the burden apparently must be minimal. *See id.* He went on to note the difficulty of the subject matter at hand, questioning whether any court could properly analyze whether smaller municipalities would be put at such a disadvantage in invalidating the law that it should instead remain in effect. *Id.* Further, “any attempt to place a definite value on this feature of the existing system would have to confront the what-if questions.” *Id.* Justice Souter is certainly right in noting that there would be “what-if questions,” but the more important point he failed to mention is that there would be “what-if questions” in every single case where the Court applies *Pike*. Other commentators have agreed that the *Pike* balancing test is inherently flawed in that it requires a judge to weigh the burdens and benefits of a statute without any real knowledge or guidance. *See Michael J. Ruttinger, Is There a Dormant Extraterritoriality Principle?: Commerce Clause Limits on State Antitrust Laws*, 106 MICH. L. REV. 545, 565 (2007).

108. *Davis*, 128 S. Ct. at 1818. It seems somewhat odd that Justice Souter confined his analysis of *Pike*’s inadequacies to economic issues. He cited to both *Tracy* and *Fulton Corp.* in suggesting “the unsuitability of the judicial process and judicial forums for making whatever predictions and reaching whatever answers are possible at all” with regard to economic and taxation issues. *Id.* (citing *Tracy*, 519 U.S. at 308 (“[T]he Court is institutionally unsuited to gather the facts upon which economic predictions can be made, and professionally untrained to make them.”); *see also* *Fulton Corp. v. Faulkner*, 516 U.S. 325, 342 (1996) (“[C]ourts as institutions are poorly equipped to evaluate with precision the relative burdens of various methods of taxation. The complexities of factual economic proof always present a certain potential for error” (quoting *Minneapolis Star & Tribune Co. v. Minn. Comm’r of Revenue*, 460 U.S. 575, 589–90 (1983))). The Justices, as very intelligent individuals, are certainly capable of understanding taxation and general economic issues just as well as a legislator could. However, the issue is not comprehension of the subject material, but rather the unwillingness of the Court to impede on Congress’s policy choices with regard to economics in general and taxation policies in particular. However, the Court should not confine its unwillingness to interfere with policy objectives solely in the arena of economic and taxation issues. In his concurrence, Justice Scalia suggested that the Court will remain incapable of properly balancing policy objectives in every single case. *Davis*, 128 S. Ct. at 1821 (Scalia, J., concurring in part). He noted that, “[o]f course you cannot decide which interest ‘outweighs’ the other without

to economic issues, “[t]he complexities of factual economic proof always present a certain potential for error,” and thus the judicial branch is ill suited to answer such cost–benefit questions.¹⁰⁹ Instead, Justice Souter suggested that Congress, comprised of the people’s elected representatives, is the most appropriate body to consider whether the differential tax system is a benefit that should be retained or a burden that should be eradicated.¹¹⁰

Finally, Justice Souter closed by reiterating that the differential taxation scheme has been a vital form of financing for nearly a century.¹¹¹ For him, the risk of upsetting the bond market by ruling against Kentucky was too great.¹¹² In the end, “[t]he fact that the system has been in force for a very long time is of itself a strong reason . . . for leaving any improvement that may be desired to the legislature.”¹¹³

B. Justice Stevens’s Concurring Opinion

Justice Stevens’s concurring opinion¹¹⁴ is very interesting because he previously joined Justices Alito and Kennedy in dissenting from the majority in *United Haulers*.¹¹⁵ In *Davis*, Justice Stevens distinguished the two cases by saying that while *United Haulers* dealt with the state entering into a private market, here, Kentucky did not “engage in [a] private trade or

deciding which interest is more important to you. And that will always be the case.” *Id.*

109. *Davis*, 128 S. Ct. at 1818.

110. *Id.* at 1819. Justice Souter rightly advocated that Congress is the more appropriate forum to resolve this issue for two reasons. *Id.* First, Congress has the ability to compile more information regarding the advantages and disadvantages of the system, and second, Congress, as an elected body, is more appropriately situated to take the economic risk of failure. *Id.* Again, however, Justice Souter’s remarks beg the question—if Congress is the more appropriate body to make the policy decision in this case, won’t they always be better suited to make it? Is there ever a time when Congress will have less of an ability to gather information, or when Congress, as an elected body, will not be more responsible to the people than the Court?

111. *Id.*

112. *Id.*

113. *Id.* (quoting *Paddell v. City of New York*, 211 U.S. 446, 448 (1908)). This line of reasoning certainly seems to intimate that the fact that the system has been in place for such a long time without intervention by Congress means that the Court should not interfere with it. Such reasoning would certainly resonate with Justices Scalia and Thomas, who would prefer that the Court abstain from adjudicating cases under the negative Commerce Clause. See *infra* note 130 and accompanying text.

114. Justice Stevens also joined the majority opinion in full. *Davis*, 128 S. Ct. at 1804.

115. *Id.* at 1819 (Stevens, J., concurring). Recall that in *United Haulers*, the Court first made the public interest versus private interest distinction in a negative Commerce Clause setting and held that because the discriminatory law would benefit the public central waste management authority and treat all private companies, whether in or out-of-state, the same, the law was acceptable and was not discriminatory under the negative Commerce Clause. *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1795 (2007). The dissent, which Justice Stevens joined at that time, squarely rejected the notion that such a public–private distinction even existed, saying that “[t]he public–private distinction drawn by the Court is both illusory and without precedent.” *Id.* at 1804 (Alito, J., dissenting).

business.”¹¹⁶ He moved on to state that Kentucky’s decision not to tax the bonds was done merely to “enhance[] the marketability of Kentucky bonds in the Kentucky market, motivating local support for local public improvements.”¹¹⁷ Justice Stevens concluded that instituting a tax break to encourage people to lend money to the state is not something which necessitates judicial scrutiny under the negative Commerce Clause.¹¹⁸

116. *Davis*, 128 S. Ct. at 1820 (Stevens, J., concurring). Justice Stevens’s rationale with regard to whether Kentucky entered into a private trade or business seems somewhat amiss. He explained that “if a State merely borrows money ‘to pay for spending on transportation, public safety, education, utilities, and environmental protection,’ . . . it does not ‘operat[e] a commercial enterprise’ for purposes of the dormant Commerce Clause.” *Id.* (quoting *C & A Carbone, Inc. v. Clarkstown*, 511 U.S. 383, 399 (1994)). He then went on to quote from the *United Haulers* dissent, which he had joined, and stated, “[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 in which there is an established interstate market.’” *Id.* (quoting *United Haulers*, 127 S. Ct. at 1794 (Alito, J., dissenting)). Justice Stevens, attempting to maneuver away from his previous position that there is no public-private distinction under the negative Commerce Clause, seemed to stretch the definition of a fee-for-service enterprise by claiming that when a state issues a bond to pay for needed services, it has not engaged in a private trade or business. Justice Stevens then contradicted himself, apparently realizing that municipal bonds are part of a larger bond trading market, when he stated that “[b]y issuing bonds in lieu of increasing taxes, Kentucky has *enlarged the interstate market for securities.*” *Id.* (emphasis added). This of course, is part of the larger issue which the dissent emphasized, as Justice Kennedy insisted that it isn’t even the issuance of bonds that is at issue; rather, it is the preferential way that the state chose to exclude the bonds from income taxation. *Id.* at 1825 (Kennedy, J., dissenting) (“The challenged state activity is differential taxation, not bond issuance. The state tax provision at issue could be repealed tomorrow without altering or impairing a single obligation in the bonds. It is the tax that matters; and Kentucky gives favored tax treatment to some securities but not others depending solely upon the State of issuance, and it does so to disadvantage bonds from other States.”).

117. *Id.* at 1820 (Stevens, J., concurring). The irony of Justice Stevens’s statement is that he suggested that the tax exemption enhanced the position of the bonds in the marketplace while continuing to claim that the bonds are not actually in a market at all. He went on to state that “[i]nstead of issuing bonds, Kentucky could have borrowed funds from a Kentucky bank or issued notes to a syndicate of Kentucky lenders without implicating the Commerce Clause.” *Id.* However, here again he seems to miss the point that it is the taxation of the bonds rather than the issuance of them that is the main issue for the *Davises*. The more apt analogy would be if the state borrowed funds from a Kentucky bank and then offered the bank a tax break in exchange for a lower interest rate on the money borrowed.

118. *Id.* at 1820–21. The exact language of Justice Stevens’s closing remarks is interesting in that it impliedly recognizes a public-private distinction. *Id.* Justice Stevens stated that “[i]n my judgment state action that motivates the *State’s taxpayers* to lend money to the *State* is simply not the sort of ‘burden’ on interstate commerce that is implicated by our dormant Commerce Clause jurisprudence.” *Id.* (emphasis added). Justice Stevens’s entire argument is predicated on the fact that the state itself is the recipient and beneficiary of the bonds. The Court’s opinion did not consider whether the state could exempt taxes on bonds which funded projects for private entities. *Id.* at 1805 n.2 (majority opinion). Based upon Justice Stevens’s comments, he very well might not allow such a tax break, because it is not the state borrowing money for its own purposes. While this would seem to be the very sort of public-private distinction the Court adopted, nowhere in Justice Stevens’s concurrence did he actually adopt the distinction. *Id.* at 1819–21 (Stevens, J., concurring).

C. Chief Justice Roberts's Concurrence In Part

Chief Justice Roberts was very brief in his concurrence, noting that he joined all parts of Justice Souter's opinion except for Part III-B, in which Justice Souter discussed the application of the market participant doctrine.¹¹⁹ In the Chief Justice's view, the case was adequately decided by the rule announced in *United Haulers*, with no need to apply what he called the "alternative analysis" of the market participant doctrine.¹²⁰

D. Justice Scalia's Concurrence In Part

Justice Scalia began his concurrence¹²¹ by stating that he joined the opinion of the Court with the exception of its discussion of the market participant doctrine and the *Pike* balancing test.¹²² His analysis turned on whether or not *stare decisis* demanded that he apply the negative Commerce Clause.¹²³ Here, Justice Scalia determined that *stare decisis* did not compel

Therefore, his concurrence here seems to be somewhat of an anomaly based upon the unique fact situation of a state borrowing money. Based upon his refusal to renege on his dissent in *United Haulers*, it seems likely that Justice Stevens would rejoin Justices Kennedy and Alito dissenting in a different case in which the Court attempts to apply the civic responsibility exception. *See id.* at 1819.

119. *Id.* at 1821 (Roberts, C.J., concurring in part).

120. *Id.* Here, a rift in how the Court wants to construct its new doctrine is apparent. Chief Justice Roberts wrote the opinion for the Court in *United Haulers*, but he did not include an analysis under the market participant doctrine. *United Haulers*, 127 S. Ct. 1786, 1789–98. This indicates that he would prefer that the Court's new exception to the negative Commerce Clause stand out as a separate exception from the market participant doctrine. It is, however, somewhat odd that the Chief Justice apparently assigned the opinion to Justice Souter, whose writing on the market participant doctrine in connection with the newly recognized public-private exception was only favored by two other members of the Court. *See* G. Edward White, *The Internal Powers of the Chief Justice: The Nineteenth-Century Legacy*, 154 U. PA. L. REV. 1463, 1476 (2006) ("The current assignment power of the Chief Justice exists in a context in which cases set for disposition by the Court's conference are discussed in a regular order, based on seniority, and in which the Chief Justice is expected to assign opinions when he is with the majority and the most senior associate Justice with the majority to assume that role when the Chief opposes the majority's disposition."). The Chief Justice perhaps assigned the opinion to Justice Souter based upon the latter's strong dissent in *Carbone*, in which he unleashed the first volley in the public-private debate. *See* *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 419–422 (1994) (Souter, J., dissenting). Whatever the reasoning, Justice Souter took full advantage of his assignment. He not only applied the market participation doctrine to the facts in *Davis*, but he also went back and displayed how *United Haulers* could be analyzed under the market participation doctrine. *Davis*, 128 S. Ct. at 1813. (plurality opinion). Chief Justice Roberts could not have been happy, as he retorted that the case at hand was "readily resolved" by the civic responsibility exception announced in *United Haulers* and that a majority of the Court shared his view. *Id.* at 1821 (Roberts, C.J., concurring in part).

121. Justice Scalia joined Justice Souter's majority opinion except as to Part III-B and Part IV. *Id.* at 1821 (Scalia, J., concurring in part).

122. *Id.* Like the Chief Justice, Justice Scalia did not feel a need to join Part III-B's discussion of the market participant doctrine because the case had already been resolved by Part III-A. *Id.*; *see supra* note 120.

123. *Davis*, 128 S. Ct. at 1821 (Scalia, J., concurring in part). Justice Scalia's hesitance to apply

him to apply the negative Commerce Clause because doing so would expand the scope of the doctrine and interfere with the states' right to regulate.¹²⁴ Thus, because the negative Commerce Clause is inapplicable in his analytical framework, Justice Scalia was unable to find fault with Kentucky's differential taxation scheme.¹²⁵

Justice Scalia next discussed the application of the *Pike* balancing test. He chose not to join the majority's analysis of *Pike*, not because he thought

the negative Commerce Clause is likely an extension of his belief that the Court incorrectly interpreted the Commerce Clause when it recognized an implied restriction on the states. Justice Scalia has previously stated that "the so-called 'negative' Commerce Clause is an unjustified judicial invention, not to be expanded beyond its existing domain." *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 312 (1997) (Scalia, J., concurring). While Justice Scalia is loathe to apply the negative Commerce Clause, he has shown a willingness to apply it where stare decisis demands that he do so. For instance, in 1988 Justice Scalia wrote for a unanimous Court in *New Energy*, stating in broad, sweeping terms that "[i]t has long been accepted that the Commerce Clause not only grants Congress the authority to regulate commerce among the States, but also directly limits the power of the States to discriminate against interstate commerce." *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273 (1988). For Justice Scalia today, the negative Commerce Clause should only be applied where necessary to help create the national market the founders envisioned when creating the Commerce Clause. Justice Scalia has been adamant in stating that:

In our zeal to advance this policy [of creating a national marketplace], however, we must take care not to overstep our mandate, for the Commerce Clause was not intended "to cut the States off from legislating on all subjects relating to the health, life, and safety of their citizens, though the legislation might indirectly affect the commerce of the country."

Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 596 (1997) (Scalia, J., dissenting) (quoting *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 443-44 (1960)). What Justice Scalia seems to offer is both an originalist interpretation of the Constitution mingled with a belief in the importance of federalism. However, Justice Kennedy argued that this is exactly the type of case where the Court would not be overstepping its mandate because of the need to protect the national marketplace from a discriminatory law. *Davis*, 128 S. Ct. at 1826 (Kennedy, J., dissenting) ("Differential taxation favoring local trade over interstate commerce poses serious threats to the national free market because the taxing power is at once so flexible and so potent.").

124. *Davis*, 128 S. Ct. at 1821 (Scalia, J., concurring in part). Because of his interpretation of the Constitution, Justice Scalia will only apply the negative Commerce Clause when a state law that either "facially discriminates against interstate commerce" or "is indistinguishable from a type of law previously held unconstitutional by this Court" is challenged. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 210 (1994) (Scalia, J., concurring in judgment). This case fits into neither category, and in Justice Scalia's opinion, applying the negative Commerce Clause to this situation would impermissibly expand the doctrine. *Davis*, 128 S. Ct. at 1821 (Scalia, J., concurring in part). It is interesting to note that part of Justice Scalia's rationale is that Kentucky was performing a traditional government function. *Id.* The dissent blasted both Justice Scalia's partial concurrence and the majority opinion for referring to the importance of traditional government functions. *Id.* at 1824 (Kennedy, J., dissenting). Justice Kennedy felt that it was an error to rely on traditional government functions and responsibilities in upholding the Kentucky statute. *Id.* As Justice Kennedy stated, the focus on traditional government functions "is but a reformulation of the phrase 'police power,' long abandoned as a mere tautology. It is difficult to identify any state law that has come before us that would not meet the Court's description." *Id.*

125. *Davis*, 128 S. Ct. at 1821 (Scalia, J., concurring in part).

that it should not have been applied in this specific case, but rather because he thought that it should not be applied in *any* case.¹²⁶ To apply *Pike* here, Justice Scalia explained, “is a matter not of weighing apples against apples, but of deciding whether three apples are better than six tangerines.”¹²⁷

126. *Id.* The Court had declined to apply *Pike* in this case because the judicial branch is ill suited to weigh the costs and benefits of a differential taxation scheme like the one at issue. *Id.* at 1818 (majority opinion); see *supra* notes 104–109 and accompanying text. Justice Scalia stated that *Pike* should never be applied because “courts are less well suited than Congress to perform this kind of balancing in every case.” *Id.* at 1821 (Scalia, J., concurring). Justice Scalia’s argument is that in every negative Commerce Clause case when the Court applies *Pike*, it will necessarily have to balance the interests of discrimination against nondiscrimination. *Id.* In doing so, the Court will have to make a policy decision as to whether discrimination is better for reason X or nondiscrimination is better for reason Y. *Id.* In *Bendix Autolite Corp. v. Midwesco Enterprises, Inc.*, 486 U.S. 888, 897 (1988) (Scalia, J., concurring), Justice Scalia suggested that *Pike* should be abandoned because the interests on either side will always be incommensurate. In *Pike*’s place, Justice Scalia suggested a test under which “a state statute is invalid under the Commerce Clause if, and only if, it accords discriminatory treatment to interstate commerce in a respect not required to achieve a lawful state purpose.” *Id.* at 898. He would then leave to Congress the determination of whether the state purpose was important enough to be a burden on interstate commerce. *Id.* Justice Scalia has apparently shifted his view on *Pike*. In his dissent in *Camps Newfound*, one of the ways that Justice Scalia suggested to the Court that it could find the Maine statute (which gave tax benefits to charities serving primarily Maine residents) valid was “on the ground that it does not constitute ‘facial discrimination’ against interstate commerce and readily survives the *Pike* v. Bruce Church balancing test.” *Camps Newfound*, 520 U.S. at 608 (Scalia, J., dissenting). His argument in *Camps Newfound* may have been motivated by his knowledge that since the Court has not abandoned *Pike*, he had to play by the rules and suggest an alternative that was at least theoretically acceptable to the Court. Despite the fact that *Camps Newfound* was decided just over ten years ago, today Justice Scalia again “would abandon the *Pike*-balancing enterprise altogether and leave these quintessentially legislative judgments with the branch to which the Constitution assigns them.” *Davis*, 128 S. Ct. at 1821 (Scalia, J., concurring in part). In his concurrence, Justice Thomas did not directly refer to the *Pike* balancing test, but did state that he “would entirely ‘discard the Court’s negative Commerce Clause jurisprudence.’” *Id.* at 1822 (Thomas, J., concurring in judgment) (quoting *United Haulers*, 127 S. Ct. at 1799 (Thomas, J., concurring in judgment)). In doing so, he would of necessity also have to discard the *Pike* balancing test. See *id.* at 1822. Although Justice Thomas declined to discuss *Pike* at length in this opinion, he has written directly about *Pike* balancing in the past. For instance, in his scholarly dissent in *Camps Newfound*, Justice Thomas stated that “[w]e have used the Clause to make policy-laden judgments that we are ill equipped and arguably unauthorized to make.” *Camps Newfound*, 520 U.S. at 618 (Thomas, J., dissenting). Justice Thomas went on to state that of the many problems with *Pike*, two of the largest are that it “invites us, if not compels us, to function more as legislators than as judges” and that such balancing tests have “allowed us to reach different results based merely ‘on differing assessments of the force of competing analogies.’” *Id.* at 619–20 (quoting *Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 196 n.7 (1995)). Justice Thomas, like Justice Scalia, would allow Congress to retain the sole power to make such competing policy decisions. *Id.* at 620.

127. *Davis*, 128 S. Ct. at 1821 (Scalia, J., concurring in part). *Davis* was not the first case in which Justice Scalia penned such a witty analogy. In *Bendix*, Justice Scalia stated that applying the *Pike* balancing test is “like judging whether a particular line is longer than a particular rock is heavy.” *Bendix*, 486 U.S. at 897 (Scalia, J., concurring in the judgment). As currently constituted, the Court seems to increasingly disfavor the use of *Pike*. As five other members joined Justice Souter’s majority opinion stating that it would be improper to apply *Pike* in this instance, and two other members have called for the outright rejection of *Pike*, the vast majority of the Court seems aligned against making legislative policy judgments, especially in economic policy cases like *Davis*. See *Davis*, 128 S. Ct. at 1804–30.

E. Justice Thomas's Concurrence in Judgment

Justice Thomas concurred with the judgment of the Court¹²⁸ that Kentucky's differential taxation scheme was constitutional, but for an entirely different reason than what Justice Souter's majority opinion proposed.¹²⁹ Justice Thomas found the scheme to be constitutional because, under his interpretation of the Constitution, there should not be a negative Commerce Clause.¹³⁰ Consequently, the taxation scheme could not possibly be a violation of a doctrine that should not exist.¹³¹ Justice Thomas noted that the taxation scheme that Kentucky employs is not only commonplace currently, but has been utilized by states for decades.¹³² He reasoned that

128. *Davis*, 128 S. Ct. at 1821–22 (Thomas, J., concurring in judgment). While Justice Thomas agreed with the ultimate result of the majority opinion, he did not agree with the analysis and did not join any part of the majority opinion. *Id.*

129. *Id.*

130. *Id.* Justice Thomas took Justice Scalia's argument to its logical conclusion. Rather than relying on *stare decisis* to justify application of the negative Commerce Clause in limited circumstances, Justice Thomas instead argued that the negative Commerce Clause should be entirely discarded. *Id.* Justice Thomas has formerly stated that "[t]he negative Commerce Clause has no basis in the Constitution and has proved unworkable in practice." *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1799 (2007) (Thomas, J., concurring). One of the largest problems with the negative Commerce Clause from Justice Thomas's perspective is that because it is not rooted in the text of the Constitution, the application of the doctrine turns on the Court's preference for one policy over another. *Id.* at 1800. Justice Thomas reasoned that "the text of the Constitution makes clear that the Legislature—not the Judiciary—bears the responsibility of curbing what it perceives as state regulatory burdens on interstate commerce." *Davis*, 128 S. Ct. at 1822 (Thomas, J., concurring in judgment).

131. *Davis*, 128 S. Ct. at 1822 (Thomas, J., concurring in judgment). Because Congress has been silent with regard to the states' differential taxation schemes, Justice Thomas stated that "we have no authority to invalidate Kentucky's differential tax scheme." *Id.*

132. *Id.* The majority opinion also noted that all states, even those that do not have a similar tax plan, supported Kentucky in this litigation. *Id.* at 1818 (majority opinion) ("It is striking, after all, that most of the harms allegedly flowing directly or indirectly to Kentucky's sister States and their citizens have failed to dissuade even a single State from supporting the current system; every one of them, including States with no income tax, have lined up with Kentucky in this case."). The dissent found this argument to be completely unavailing. *See id.* at 1828 (Kennedy, J., dissenting). Justice Kennedy stated that the fact that every other state lined up behind Kentucky did not matter because "[p]rotectionist interests always want the laws they pass, even if their fellow citizens bear the burden." *Id.* However, Justice Kennedy did not seem to account for the states that do not have a bond differential taxation scheme (largely those that lack a state income tax) and yet still support the scheme employed by other states. The amici curiae brief onto which all states signed that tells the real story as to why every state wanted this long-practiced taxation scheme to remain in place. *See Brief for the States*, *supra* note 5. As explained by the amici, had Justices Kennedy and Alito prevailed in affirming the ruling of the Kentucky court below, it would have "put the 'bond market into an unprecedented upheaval,'" and would cause bonds held by residents of all fifty states to be substantially devalued. *Id.* at 1 (quoting Timothy P. Noonan & David Martin, *U.S. Supreme Court's Decision to Hear Municipal Bond Case Raises Constitutional, Procedural Questions*, 44 STATE TAX

because Congress has had nearly a century to regulate in this area, but has chosen not to do so, the Court has no authority to step in and regulate in place of Congress.¹³³ His reasoning in this case also comports with his long-held view that the *Pike* balancing test should be removed from the Court's jurisprudence.¹³⁴

F. Justice Kennedy's Dissent

Justice Kennedy began his dissent by referencing the importance of free trade to the founding of the United States.¹³⁵ His dissent suggested that it is

NOTES 969 (2007). It is apparent that Justice Thomas was correct in his reasoning that the differential taxation system should continue, at least in part, because the bond market needs stability in order to properly function.

133. *Davis*, 128 S. Ct. at 1822. In his dissent in *Camps Newfound*, Justice Thomas made a very interesting argument with regard to the constitutionality of the Court stepping in to enforce the Commerce Clause without Congress having acted first. See *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 617 (1997). Justice Thomas approached the issue from a statutory interpretation standpoint, noting that some people have advanced the theory that with silence, Congress could have attempted to preempt the field. *Id.* He stated that the idea of legislation by silence may be impermissible because of the Constitutionally mandated requirements of bicameralism and presentment. *Id.*; see U.S. CONST. art. 1, § 7, cl. 2 ("Every Bill which shall have passed the House of Representatives and the Senate, shall, before it become a Law, be presented to the President of the United States . . ."); U.S. CONST. art. 1, § 7, cl. 3 ("Every Order, Resolution, or Vote to which the Concurrence of the Senate and House of Representatives may be necessary . . . shall be presented to the President of the United States; and before the Same shall take Effect, shall be approved by him, or being disapproved by him, shall be repassed by two thirds of the Senate and House of Representatives, according to the Rules and Limitations prescribed in the Case of a Bill."). Justice Thomas went on to state that "even were we wrongly to assume that congressional silence evidenced a desire to pre-empt some undefined category of state laws, . . . treating unenacted congressional intent as if it were law would be constitutionally dubious." *Camps Newfound*, 520 U.S. at 617 (Thomas, J., dissenting). The states certainly support Justice Thomas in his argument here. In their Brief as amici, the states noted that "[t]he long continued silence of Congress, with its plenary power, in the presence of . . . [state legislation] is itself an implied ratification and adoption, and is equivalent in its consequences to an express declaration to that effect." Brief for the States, *supra* note 5, at 20 (quoting *Wilson v. McNamee*, 102 U.S. 572, 575 (1880)). The states went on to point out that Congress was aware of the differential taxation scheme in place at the state level here because in 1959 Congress had ordered a report to look at state taxation practices and after noting the differential taxation of bonds, took no steps to stop the practice. *Id.* at 20–21.

134. Justice Thomas would entirely eradicate the *Pike* balancing test. *Camps Newfound*, 520 U.S. at 619–20. In *Camps Newfound*, Justice Thomas stated that "in an unabashedly legislative manner, we have balanced that 'effect' against the perceived interests of the taxing or regulating State." *Id.* at 619. He maintained that the test is constructed in such a way as to effectively compel the Court to act as legislators rather than as judges. *Id.* A further problem with *Pike* is that it has allowed the Court to reach results predicated only upon policy considerations and competing analogies. *Id.* This certainly seems to be in line with Justice Souter's assessment of *Pike*'s usefulness in this case. See *supra* notes 104–109 and accompanying text. As Justice Souter noted, "the current record and scholarly material convince us that the Judicial Branch is not institutionally suited to draw reliable conclusions of the kind that would be necessary for the Davises to satisfy a *Pike* burden in this particular case." *Davis*, 128 S. Ct. at 1817; see *supra* note 110 and accompanying text.

135. *Davis*, 128 S. Ct. at 1822 (Kennedy, J., dissenting). Justice Kennedy stated that free trade was a primary objective of the founders. *Id.* He went on to suggest that "[t]he national, free

necessary “to discourage new experiments with local laws that discriminate against interstate commerce and trade.”¹³⁶ Justice Kennedy reasoned that while the bond market at issue here may be able to deal with such discrimination, the holding of the Court impermissibly undermines negative Commerce Clause jurisprudence—a holding that may lead to discrimination in other discrete markets and more damaging outcomes.¹³⁷ In discussing the merits of this case, Justice Kennedy noted that traditionally the Court has found unconstitutional “laws that impose unreasonable burdens upon interstate commerce; and laws that discriminate against it.”¹³⁸ He stated that because of the Court’s active participation in this area, national legislation has not been needed to end discriminatory practices.¹³⁹

market . . . has been a singular force in shaping the consciousness and creating the reality that we are one in purpose and destiny.” *Id.* He went on to call the Court’s decisions under the Commerce Clause both “appropriate and necessary to [achieve] the Constitution’s purpose.” *Id.* Justice Kennedy noted that before the adoption of the Constitution, the Articles of Confederation had allowed states to enact protectionist laws. *Id.* at 1823. Professor Robert N. Clinton argues that the failure of the founders to provide for federal power over interstate commerce in the Articles of Confederation stemmed from the fact that most contemporary commerce took place between the colonies and Europe and the Indian tribes, not between the actual colonies themselves. Robert N. Clinton, *A Brief History of the Adoption of the United States Constitution*, 75 IOWA L. REV. 891, 894 (1990). The result was increasing competition among the states and numerous barriers to trade. *Davis*, 128 S. Ct. at 1823 (Kennedy, J., dissenting).

136. *Davis*, 128 S. Ct. at 1823 (Kennedy, J., dissenting). The dissent stated that the majority’s decision was inconsistent with the Court’s precedent. *Id.* In this sense, the dissent seemed to be grasping onto *Carbone* and to their own dissenting argument in *United Haulers*. In *United Haulers*, Justice Alito dissented by arguing that “[t]he fact that the flow control laws at issue discriminate in favor of a government-owned enterprise does not meaningfully distinguish this case from *Carbone*.” *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1804 (2007) (Alito, J., dissenting). But of course, Justice Alito lost that battle, and it indeed became meaningful, however nominally, that the facility in operation in *United Haulers* was owned by the public whereas the operation in *Carbone* was private. Therefore, to say that the decision in *Davis* was inconsistent with the Court’s precedent is categorically wrong. In the only other case where the Court considered a statute which benefited a public entity, the Court found no violation of the negative Commerce Clause. *Id.* at 1797.

137. *Davis*, 128 S. Ct. at 1822 (Kennedy, J., dissenting). Justice Kennedy stated that the so-called discrimination the Court upheld could be managed, despite extra accommodation costs. *Id.* However, it would seem that the greater accommodation costs would be in scrapping the system altogether. One amici suggested that if the Court were to invalidate the taxation scheme, “the disruption to the existing municipal bond market, and the adjustment from a system that has prevailed for close to a century, would be substantial.” Brief for the National Federation of Municipal Analysts, *supra* note 102, at 16. The amici further noted that if the Davises had won, there would have been a period of uncertainty during which investors would be unsure how municipal bonds would be taxed, leading to a devaluation of outstanding bonds and difficulty in selling new bonds. *Id.* at 22.

138. *Davis*, 128 S. Ct. at 1824 (Kennedy, J., dissenting).

139. *Id.* (“The result is to eliminate the demand and necessity for sweeping national legislation.”). If saving Congress the trouble of legislating is the goal, perhaps Justice Kennedy would be pleased

Justice Kennedy began his analysis by first noting and then rejecting the Court's reliance on the assertion that Kentucky's bond scheme serves a traditional government function.¹⁴⁰ The dissent stated that the Court's reliance on traditional government functions is merely a disguise for a state's police powers and that a claim of police powers cannot save a law from scrutiny under the negative Commerce Clause.¹⁴¹

to have the Court take over other legislative functions. But alas, the Supreme Court as legislator is not delineated in the Constitution. Article I, Section 1 of the United States Constitution clearly and unequivocally establishes that "[a]ll legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives." U.S. CONST. art. I, § 1. Conversely, "[t]he judicial Power of the United States, shall be vested in one Supreme Court." U.S. CONST. art. III, § 1. Contrary to Justice Kennedy's assertion, the founders apparently never contemplated giving the Court the power to legislate. Indeed, some constitutional scholars have suggested that the Court should simply completely avoid all commercial cases. *See, e.g.*, Steven Breker-Cooper, *The Commerce Clause: The Case for Judicial Non-Intervention*, 69 OR. L. REV. 895, 896 (1990). Professor Steven Breker-Cooper suggests that "[g]iven Congress' power to preempt both state law and Court decisions in this area, however, there is considerably less need for Court intervention. Thus . . . the Court should no longer hear commercial cases." *Id.* (footnote omitted).

140. *Davis*, 128 S. Ct. at 1824 (Kennedy, J., dissenting). Justice Kennedy suggested that the Court vindicated Kentucky's bond scheme merely because it served a "beneficial purpose." *Id.* However, the Court's decision was not so narrow as to suggest that any law which is beneficial must be upheld. The distinction which the Court made was that laws that favor traditional government functions and do not discriminate against private businesses are not discriminatory under the Commerce Clause. *Id.* at 1811 (majority opinion); *United Haulers*, 127 S. Ct. at 1790 ("Disposing of trash has been a traditional government activity for years, and laws that favor the government in such areas—but treat every private business, whether in-state or out-of-state, exactly the same—do not discriminate against interstate commerce for purposes of the Commerce Clause.").

141. *Davis*, 128 S. Ct. at 1824 (Kennedy, J., dissenting). Justice Kennedy wrote that holding up a state action as a police power is merely an end run around normal constitutional restraints. *Id.* The case to which Justice Kennedy cited as authority was a curious choice, as the facts are not on all fours with the scenario in *Davis*. Justice Kennedy cited to Justice Holmes's opinion for the Court in *Kansas City Southern Railway Co. v. Kaw Valley Drainage District*. *Id.* at 1824–25. That case, now nearly 100 years old, dealt with the need to provide for transportation after the Kansas River flooded its banks. *Kansas City S. Ry. Co. v. Kaw Valley Drainage Dist.*, 233 U.S. 75, 76 (1914). In response, the Kaw Valley Drainage District, on authority from the state, ordered the railroads to remove their old bridges and build new ones at a greater height. *Id.* The Court noted that because the railroads were part of interstate commerce, the "subject-matter is under the exclusive control of Congress." *Id.* at 78. Justice Holmes went on to state that, "[i]t repeatedly has been said or implied that a direct interference with commerce among the States could not be justified [with police powers]." *Id.* at 79. The key, and very relevant, distinction between *Davis* and *Kaw Valley* is that the latter involved a government entity attempting to use police powers in order to mandate that a *private* entity take action. *Davis* contains no similar facts, and in fact all private bond issuers are treated exactly alike by Kentucky's statute. This was the distinction Justice Souter drew—a distinction that, apparently, Justice Kennedy failed to grasp. As Justice Souter wrote, "[u]nder *United Haulers*, governmental public preference is constitutionally different from commercial private preference, and we make the governmental responsibility enquiry to identify the beneficiary as one or the other." *Davis*, 128 S. Ct. at 1811 n.9 (also noting that "[b]ecause this is the distinction at which the enquiry about traditional governmental activity is aimed, it entails neither tautology nor the hopeless effort to pick and choose among legitimate governmental activity"). Chief Justice Roberts, in *United Haulers*, wrote that the Court should not do that for which Justice Kennedy advocates: "rigorously scrutinize economic legislation passed under the auspices of the police power." *United Haulers*, 127 S. Ct. at 1798. The Chief Justice went on to state that "[t]here was a

The dissent then discussed one of the major points of contention—whether the challenge should be directed at Kentucky’s issuance of bonds, Kentucky’s differential tax scheme, or the two provisions together as one.¹⁴² Justice Kennedy stated that the real “challenged state activity is differential taxation, not bond issuance.”¹⁴³ Working from this premise, the dissent found the case to be quite simple as a state cannot use its taxing powers to create barriers to commerce in the interstate market.¹⁴⁴ Justice Kennedy stated that such discriminatory taxes “pose[] serious threats to the national

time when this Court presumed to make such binding judgments for society, . . . [but] [w]e should not seek to reclaim that ground for judicial supremacy under the banner of the dormant Commerce Clause.” *Id.* (citation omitted).

142. *Davis*, 128 S. Ct. at 1825 (Kennedy, J., dissenting).

143. *Id.* Justice Kennedy suggested that the law at issue affects the purchasers of the bond, not the issuer. *Id.* He went on to note that the state could easily get rid of the tax exemption, and its obligations to repay the bonds would remain the same. *Id.* This is certainly true; however Justice Kennedy misses the point. Kentucky does not have a tax exemption in order to somehow affect the obligation that it owes to repay bonds. Certainly Justice Kennedy is right when he states that the tax “could be repealed tomorrow without altering or impairing a single obligation in the bonds.” *Id.* However, it *could not* be repealed tomorrow without significantly affecting Kentucky’s and its political subdivisions’ ability to sell new bonds. *That* is the entire purpose of the tax exemption—to allow Kentucky to raise revenue, a traditional government function, for the benefit of its people. As one amici noted, if the tax exemption were taken away, some government entities would have trouble selling bonds at all, even at higher interest rates. Brief for the National Federation of Municipal Analysts, *supra* note 102, at 19 (“Such smaller issuers would stand to lose much of the intrastate market for the bonds that has developed under the currently prevailing state tax system without gaining much of an interstate market from its elimination.”). Undaunted, Justice Kennedy went on to state that even if the Court was correct that taxation and bond issuance cannot be divorced, the Court would still be incorrect because “the discrimination against out-of-state commerce still would be too plain and prejudicial to be sustained.” *Davis*, 128 S. Ct. at 1825 (Kennedy, J. dissenting). For support, Justice Kennedy cited to Justice Alito’s dissenting opinion in *United Haulers*, which gained support from only three of the Court’s nine members. *Id.*; *United Haulers*, 127 S. Ct. at 1803. Justice Souter wrote that the dissent’s attempt to disaggregate the issuance of bonds and their taxation is a “denial of economic reality.” *Id.* at 1814 n.17 (plurality opinion).

144. *Davis*, 128 S. Ct. at 1825 (Kennedy, J., dissenting). This, of course, is true with regard to erecting barriers in the private marketplace. Justice Kennedy cited to a number of cases, all of which dealt with the state using the taxing power to benefit private in-state businesses. *Id.* He went on to state that “[n]othing in our cases even begins to suggest this rule is inapplicable simply because the State uses a discriminatory tax to favor its own enterprise.” *Id.* Justice Kennedy is correct that at no time before *Davis* did the Court hold that a state can use its taxing power in furtherance of traditional government activities. However, at no time did the Court rule that a state *could not* use its taxing power to benefit its own enterprise either. Justice Kennedy’s argument can be reduced to the notion that “because it has never been considered, it can never be.” Justice Kennedy is not even entirely correct in his premise. While the Court has never said a state can use its *taxing* power to favor its own enterprise, it has said that a state can use its *regulatory* power to favor its own enterprise. *United Haulers*, 127 S. Ct. at 1790. The incremental step in analysis from regulation to taxation does not seem as wide a chasm as Justice Kennedy would have us believe.

free market because the taxing power is at once so flexible and so potent.”¹⁴⁵ He next discussed a number of cases, including *Boston Stock Exchange*, *Bacchus* and *Fulton*, in which the Court held discriminatory taxes to be invalid pursuant to the negative Commerce Clause.¹⁴⁶ Justice Kennedy declared that cases holding discriminatory taxes invalid comprise merely one subset of the cases in which the Court has invalidated statutes that favor local interests over interstate commerce.¹⁴⁷

Next, the dissent analyzed the Court’s reliance on *United Haulers* in finding Kentucky’s law valid. Justice Kennedy distinguished *United*

145. *Davis*, 128 S. Ct. at 1826 (Kennedy, J., dissenting). Justice Kennedy does not state exactly what threat the differential taxation scheme presents to the national free market. *Id.*

146. *Id.* at 1825–26. Justice Kennedy first cited *Boston Stock Exchange*, noting that the Court had previously “ruled that protectionist, differential taxation with respect to securities sales is invalid.” *Id.* at 1825 (citing *Boston Stock Exch. v. State Tax Comm’n*, 429 U.S. 318 (1977)). In *Boston Stock Exchange*, the Court considered a New York statute which taxed out-of-state securities transactions more heavily than in-state securities transactions. *Boston Stock Exch.*, 429 U.S. at 319. The Court noted that it had not had the opportunity to decide “whether a State may tax in a manner that discriminates between two types of interstate transactions in order to favor local commercial interests over out-of-state businesses, but the clear import of our Commerce Clause cases is that such discrimination is constitutionally impermissible.” *Id.* at 335 (citing *Guy v. Baltimore*, 100 U.S. 434, 443 (1880); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935)). *Boston Stock Exchange* is clearly not on point with *Davis*, as in *Davis* there was no discrimination that favored “local commercial interests over out-of-state businesses.” *Id.* Quite the contrary, the statute in *Davis* is neutral with regard to in-state and out-of-state businesses. Next, Justice Kennedy held up *Bacchus Imports* as an example of a case in which a discriminatory tax exemption was struck down. *Davis*, 128 S. Ct. at 1826 (Kennedy, J., dissenting) (citing *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271 (1984)). However, the application of *Bacchus* is inappropriate for the same reason that the application of *Boston Stock Exchange* is inappropriate. In *Bacchus*, the Supreme Court struck down a Hawaii statute that taxed out-of-state private liquor sellers at a higher rate than some in-state private liquor sellers. *Bacchus*, 468 U.S. at 273. The key distinction, again, was that in *Bacchus* the state favored in-state private industry over out-of-state private industry. As such, *Bacchus* is also inapplicable to *Davis*. Finally, Justice Kennedy cited to the case *Fulton Corp. v. Faulkner*. *Davis*, 128 S. Ct. at 1826 (Kennedy, J., dissenting). In *Fulton*, the Court looked at a North Carolina scheme that taxed the value of stocks held by North Carolinians at an inverse proportion to the amount of business that the company did in the state. *Fulton*, 516 U.S. at 328. Therefore, if a company did ten percent of its business in North Carolina, residents of the state who owned the stock would pay tax on ninety percent of the value. *See id.* The Court had no trouble finding that the statute was impermissibly discriminatory because it favored “domestic corporations over their foreign competitors in raising capital among North Carolina residents.” *Id.* at 333. Sadly for Justice Kennedy, *Fulton* must also be found inapplicable because it too deals with discrimination against private out-of-state business entities for the benefit of private in-state business entities.

147. *Davis*, 128 S. Ct. at 1826–27 (Kennedy, J., dissenting). Justice Kennedy is right that the line of discriminatory tax cases make up but one part of the Court’s jurisprudence holding that a state may not enact laws to favor local businesses. He again noted a number of cases in which discrimination in favor of local products was struck down. *Id.* at 1827 (Kennedy, J., dissenting) (citing *Dean Milk Co. v. Madison*, 340 U.S. 349 (1951); *Hunt v. Washington State Apple Adver. Comm’n*, 432 U.S. 333 (1977); *C & A Carbone, Inc. v. Clarkstown*, 511 U.S. 383 (1994); *Philadelphia v. New Jersey*, 437 U.S. 617 (1978); *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269 (1988); *Hughes v. Oklahoma*, 441 U.S. 322 (1979); *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982)). Yet, in each case cited, the discrimination was in favor of local *private* interests and at the expense of out-of-state *private* interests.

Haulers from *Davis* by stating that in *United Haulers*, the fact that the government had a monopoly over the market and thus created “[n]ondiscrimination” was central to the holding.¹⁴⁸ In this way, the dissent attempted to undercut the Court’s reliance on the similarity found in *United Haulers* and *Davis*—the government’s involvement in the challenged scheme.¹⁴⁹ Although the dissent continued to reject the holding of *United Haulers*, Justice Kennedy concluded that *Davis* would not fit under the *United Haulers* rubric because there was no monopolization of the bond market by Kentucky.¹⁵⁰

Justice Kennedy then explored *Camps Newfound* and its possible application to this case.¹⁵¹ He stated that in *Camps Newfound*, the Court had already rejected “the argument that profit and not-for-profit organizations should be treated differently with respect to Commerce Clause

148. *Davis*, 128 S. Ct. at 1827 (Kennedy, J., dissenting). It is somewhat odd that Justice Kennedy argued that a state must have a monopoly in order for the rule in *United Haulers* to apply. In dissent to *United Haulers*, Justice Alito, joined by Justice Kennedy, argued vehemently against the Court’s holding, saying that the Court had “long ago recognized that the Commerce Clause can be violated by a law that discriminates in favor of a state-owned monopoly.” *United Haulers*, 127 S. Ct. at 1806 (Alito, J., dissenting). Justice Kennedy wrote in *Davis* that “[n]ondiscrimination, not just state involvement, was central to the rationale” in *United Haulers*. *Davis*, 128 S. Ct. at 1827 (Kennedy, J., dissenting). He is certainly right that nondiscrimination is important, but it is specifically nondiscrimination with respect to private entities that is central. The rule as delineated by Chief Justice Roberts merely provides that states, in favoring themselves, must “treat every private business, whether in-state or out-of-state, exactly the same.” *United Haulers*, 127 S. Ct. at 1790. Of course, a state could enact a statute which treats in-state and out-of-state private businesses exactly the same without monopolizing the market—Kentucky did exactly that with its differential taxation scheme. Indeed, Justice Kennedy’s assertion that the *United Haulers* decision was premised upon the belief that there must be a government monopoly could not be more misguided. Chief Justice Roberts, in replying to a statement made in Justice Thomas’s concurrence to *United Haulers*, wrote:

Justice Thomas is thus wrong in stating that our approach might suggest “a policy-driven preference for government monopoly over privatization. . . . That is instead the preference of the affected locality here. Our opinion simply recognizes that a law favoring a public entity and treating all private entities the same does not discriminate against interstate commerce as does a law favoring local business over all others.

Id. at 1796 n.6 (emphasis added).

149. *Davis*, 128 S. Ct. at 1827 (Kennedy, J., dissenting).

150. *Id.* It is true that in *United Haulers*, the government effectively gained a monopoly. See *United Haulers*, 127 S. Ct. at 1791–92. However, as previously discussed, the fact that the haulers had a monopoly was not dispositive of the Court’s decision. See *supra* note 148 and accompanying text. Justice Kennedy thus erroneously argued that “[t]his case is not an extension of *United Haulers*; it is a rejection of its principal rationale—that in monopolizing the local market, the ordinance applied equally to interstate and local commerce.” *Davis*, 128 S. Ct. at 1827 (Kennedy, J., dissenting). The differential taxation scheme successfully treats all in-state and out-of-state businesses the same without monopolizing the marketplace for bonds.

151. *Davis*, 128 S. Ct. at 1827–28 (Kennedy, J., dissenting).

protection.”¹⁵² Justice Kennedy equated the states with not-for-profit entities and, for him, it naturally followed that, like the latter, “there is no reason the governmental character of the bond-issuing enterprise should exclude it from the coverage of the Commerce Clause.”¹⁵³

The dissent next criticized Justice Souter’s discussion of the markets in which municipal bonds reside.¹⁵⁴ Justice Kennedy condemned the Court’s dialogue about single state bond funds, arguing that the Court incorrectly focused on the seller’s purposes, rather than on the investors’ purposes, which the dissent considered an erroneous interpretation of negative

152. *Id.* at 1828. Recall that in *Camps Newfound*, the Court considered a Maine statute that gave property and personal tax exemptions to charities operating for the benefit of Maine residents. *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 568 (1997); see *supra* notes 54–58 and accompanying text. The Court struck down the statute, reasoning that under the Commerce Clause, any supposed difference between for profit and not-for-profit entities is illusory. *Id.* at 586. Here, Justice Kennedy does find some support. The Court in *Camps Newfound* went on to state that the reason why for-profit and not-for-profit organizations must be treated the same is because they are both “major participants in interstate markets.” *Id.* For other illuminating discussions on *Camps Newfound*, see Karin J. Kysilka, *A Jurisdictional Vacuum in the Wake of Camps Newfound/Owatonna?: Camps Newfound/Owatonna v. Town of Harrison*, 21 HARV. J.L. & PUB. POL’Y 288 (1997) (arguing that the Court’s invalidation of Maine’s tax exemption may have been beyond the Court’s powers); Sara Sachse, *United We Stand—But for How Long? Justice Scalia and New Developments of the Dormant Commerce Clause*, 43 ST. LOUIS U. L.J. 695 (1999) (discussing Justice Scalia and his impact on the Court’s modern negative Commerce Clause jurisprudence); Todd Armbruster, Comment, *The Proposed Domestic Charity Exception: An Unwise Addition to the Dormant Commerce Clause Family*, 53 U. MIAMI L. REV. 333 (1999) (discussing a possible domestic charity exception to the negative Commerce Clause in response to Justice Scalia’s dissent); Note, *Dormant Commerce Clause—Application to Nonprofit Entities*, 111 HARV. L. REV. 197 (1997) (arguing that the Court was correct in not drawing a distinction between for-profit and not-for-profit entities).

153. *Davis*, 128 S. Ct. at 1828 (Kennedy, J., dissenting). In response, Justice Souter noted that *Camps Newfound* is not entirely analogous because there, “the tax exemption was unaccompanied by any market activity by the State.” *Id.* at 1814 n.17 (plurality opinion). He went on to note that the tax exemption in *Camps* favored *private*, albeit not-for-profit, charities, and therefore *Davis* and *United Haulers* remain in line with the holding in *Camps Newfound*. *Id.* Further, while Justice Kennedy apparently sees no difference between private not-for-profits and the government, Chief Justice Roberts aptly distinguished the two in *United Haulers*. He wrote that “[u]nlike private enterprise, government is vested with the responsibility of protecting the health, safety, and welfare of its citizens.” *United Haulers*, 127 S. Ct. at 1795. Therefore, “it does not make sense to regard laws favoring local government and laws favoring private industry with equal skepticism.” *Id.*

154. *Davis*, 128 S. Ct. at 1828 (Kennedy, J., dissenting). For a thorough discussion of Justice Souter’s identification of three markets, see *supra* notes 95–103 and accompanying text. Justice Kennedy suggested that the Court claimed that because bonds reside in a discrete intrastate market, the state can discriminate if it wants. *Davis*, 128 S. Ct. at 1828 (Kennedy, J., dissenting). The only problem is that the Court never stated anything near that. Instead, the Court suggested that “[b]y definition, there is no discrimination against interstate activity within the market itself.” *Id.* at 1816 (majority opinion). Justice Kennedy further criticized the Court’s analysis of the bonds in a discrete market, saying that such an argument is nowhere to be found in the record. *Id.* at 1828 (Kennedy, J., dissenting). While he was willing to admit that there is a discrete market with regard to all state and municipality issued bonds because of I.R.C. § 103(a), he refused to admit that “there are 41 further discrete markets for bonds in each of the separate States that have laws like [Kentucky].” *Id.*

Commerce Clause jurisprudence.¹⁵⁵ Justice Kennedy summarized by stating “[t]he fact that the national market for tax-free state and municipal bonds is a discrete one serves only to reinforce the point that it should operate without local restriction.”¹⁵⁶

Justice Kennedy found little support for invalidating Kentucky’s law by virtue of the fact that forty-nine other states had joined a brief in support of Kentucky’s position.¹⁵⁷ He stated that the other states would quite naturally prefer the discriminatory laws they had also passed and that worked in their favor.¹⁵⁸ The very fact that so many other states had passed differential taxation schemes was evidence that there has effectively been a trade war, to the advantage of wealthier states, in direct contradiction to the original intent of the founders.¹⁵⁹

155. *Davis*, 128 S. Ct. at 1828 (Kennedy, J., dissenting). Justice Kennedy stated that the investors’ purposes “are the touchstone of market definition.” *Id.* His larger point seems to be that the Kentucky statute should not be saved merely because smaller municipalities would have trouble financing their projects if the tax exemption were invalidated. *Id.* He noted that in *Bacchus*, the state of Hawaii argued that the tax exemption at issue was merely enacted to help nonexistent and financially troubled segments of the liquor industry. *Id.* (citing *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 272–73 (1984)). However, as in *Bacchus*, Justice Kennedy’s argument seems to be that a legitimate end cannot justify an arguably illegitimate means. Therefore, he stated that the case “cannot be resolved by determining what the issuer does with the proceeds.” *Id.* Regardless of Justice Kennedy’s viewpoint, those in the industry insist that “[t]he current municipal bond marketplace is in part a national market and in part a state by state market.” Brief for the National Federation of Municipal Analysts, as Amici Curiae Supporting Neither Party, *supra* note 102, at 12.

156. *Davis*, 128 S. Ct. at 1828 (Kennedy, J., dissenting). Justice Kennedy does not offer any reasoning as to why, assuming there is discrimination within the discrete national market for bonds, the market would be better off without that discrimination. *Id.*

157. *Id.* Justice Kennedy suggested that the Court has routinely ignored the argument that because a state’s people have chosen to bear the burden of a discriminatory scheme, the scheme should therefore be upheld. *Id.* He argued that if the Court allowed a discriminatory law to stand merely because a state’s people were in favor of the law, the Court’s entire line of discriminatory tax cases would be undermined. *Id.* at 1829. The intriguing element in *Davis*, however, is that the people are not deciding whether or not they want to accept the costs which will be paid by some private industry; they are instead deciding whether they want to pay the cost themselves through decreased tax revenue, ostensibly in exchange for a greater ability to sell municipal bonds and quickly raise revenue. According to the brief for the forty-nine other states, the people “have chosen to exempt their own bonds from taxation because it allows them to lower their borrowing costs and to increase the amount of money available to build schools, hospitals and roads.” Brief for the States, *supra* note 5, at 10.

158. *Davis*, 128 S. Ct. at 1828 (Kennedy, J., dissenting). Justice Kennedy is right to point out that the advantage is larger for higher-tax states. *Id.* at 1829. If the tax exemptions were to be overturned, then the demand for out-of-state bonds would increase “the most in the case of taxpayers in high tax states, where the tax advantage of buying in-state bonds is currently the highest.” Brief for the National Federation of Municipal Analysts, *supra* note 102, at 17.

159. *Davis*, 128 S. Ct. at 1829 (Kennedy, J., dissenting). Justice Kennedy seems to suggest that these taxing statutes are emblematic of the parade of horrors that the founders suggested would occur if the states were not prevented from erecting trade barriers. The Court in *Baldwin v. G.A.F.*

In Part II of the dissent, Justice Kennedy briefly discussed the plurality's application of the market participant doctrine.¹⁶⁰ The dissent paid little attention to the plurality's discussion, saying it needed "little comment" because "a 'tax exemption is not the sort of direct state involvement in the market that falls within the market-participation doctrine.'"¹⁶¹ Again, the disagreement came back to what the actual challenged practice was, with Justice Kennedy saying that it was clearly taxation, not the issuance of bonds.¹⁶² Because taxation is a regulatory act, the dissent suggested that the market participant doctrine was inapplicable.¹⁶³

Seeling, Inc. suggested that the purpose of the Commerce Clause is to prevent "the mutual jealousies and aggressions of the States, taking form in customs barriers and other economic retaliation." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935). Justice Kennedy suggested that by allowing the tax exemption to stand here, "the Court invites further erosion of the Commerce Clause." *Davis*, 128 S. Ct. at 1829. He went on to concoct a wild hypothetical in which states tax the interest income on out-of-state bonds at a rate of eighty percent. *Id.* Fortunately, in the nearly one-hundred years that states have been exempting their own bonds from taxation, none has come even close to sliding down the dastardly slippery slope that Justice Kennedy suggested. In fact, if we accept the premise that the purpose of the negative Commerce Clause is to prevent the mutual jealousies and aggressions between the states as the Court suggested in *Baldwin*, we see that judicial intervention is needed less here. There is no jealousy between the states in this area. There is no aggression between the states in this area. Justice Kennedy suggested that the fact that many states have similar tax exemptions means that their purpose was to enact retaliatory measures. *Id.* But again the very fact that every single state is in favor of the tax exemptions is nothing if not proof that they were not designed to be retaliatory in nature. Justice Kennedy mocked the Court for seeming "proud to say that New York was the first to enact a protectionist exemption." *Id.* The Court should be proud of New York, for the state was the first to take the risk by experimenting with a tax exemption for bonds issued within the state. As Professors Redish and Nugent have noted, the benefit of state experimentation through federalism "should be sacrificed only when the negative impact on the nation's economy is so severe that preemptive congressional action can overcome the hurdles of political inertia." See Redish, *supra* note 30, at 573–74.

160. *Davis*, 128 S. Ct. at 1829 (Kennedy, J., dissenting).

161. *Id.* (quoting *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 593 (1997)).

162. *Davis*, 128 S. Ct. at 1829 (Kennedy, J., dissenting). Justice Kennedy actually suggested that Justice Souter was trying to expand the market participant doctrine to include the state acting as a tax regulator. *Id.* He stated that if such an expansion were accepted there "would be an open invitation to enact these kinds of discriminatory laws—laws that, until today, the Court has not upheld in even a single instance." *Id.* For more on what the challenged activity was, see *supra* notes 142–147 and accompanying text.

163. *Davis*, 128 S. Ct. at 1829 (Kennedy, J., dissenting). Justice Kennedy did make an interesting argument regarding downstream regulation. He assumed, *arguendo*, that the challenged activity was simply the issuance of bonds rather than the taxation of bonds. *Id.* at 1830. He then implied that if the state sold bonds but applied a differential taxation scheme to them, the state would be acting as a downstream regulator. *Id.* The premise is once again wrong, because as Justice Souter tirelessly noted, the issuance of the bonds cannot be divorced from the differential tax. *Id.* at 1812 (plurality opinion). If the market participant doctrine were to be applied, an analysis under downstream regulation would not yield an unconstitutional statute. Under the downstream regulation rule, "the Court has refused to find that the state was a market participant when it conditioned sales on the subsequent behavior of the purchaser." Davis S. Bogen, *The Market Participant Doctrine and the Clear Statement Rule*, 29 SEATTLE U. L. REV. 543, 544 (2006). For downstream regulation to invalidate a statute, the state must require that the purchaser of its product do something down the

In closing, Justice Kennedy suggested that if the real reason the Court found the law to be valid was because of its fear that finding the law invalid would cause a massive disruption in the bond market then “there needs to be a *sui generis* exception, noting that the interstate discrimination has been entrenched in many States and for a considerable time.”¹⁶⁴ However, because the majority failed to do so, Justice Kennedy asserted that the Court had invited other protectionist laws and unwisely confined the scope of the Court’s negative Commerce Clause jurisprudence.¹⁶⁵

G. Justice Alito’s Dissent

Justice Alito wrote separately to reaffirm his view “that the Court’s established [negative] Commerce Clause precedents should be followed.”¹⁶⁶ He also noted his entire agreement with Justice Kennedy and reiterated his reasoning for dissenting to *United Haulers*.¹⁶⁷

line, out of privity of contract with the state. *Id.* There is no such requirement here. Purchasers buy municipal bonds knowing what the tax consequences will be and, once purchased, the tax structure does not mandate the purchaser’s behavior. If the market participant doctrine were to be appropriately applied, there would be no downstream regulation on the facts of this case.

164. *Davis*, 128 S. Ct. at 1830 (Kennedy, J., dissenting). The Court did not altogether refute this assertion. Indeed, Justice Souter suggested that the practical consequences of the decision did play a role in the opinion. *Id.* at 1819 n.21 (majority opinion). Justice Souter stated that “practical consequences have always been relevant in deciding the constitutionality of local tax laws.” *Id.* One interesting question is, what if the practical consequences of finding the differential tax scheme unconstitutional were not as great? What if the bond market could reorder itself easily and states and municipalities could easily find their necessary funding another way? This line of reasoning from Justice Souter almost seems to go back to a no less discriminatory alternative standard. In neither *United Haulers* nor *Davis* did it appear that there was an easier solution to the respective issues. But if there was a solution that did not cause the haulers’ rates to go up, or that did not “discriminate” against out-of-state municipal bonds, perhaps the Court would have been less willing to invoke its new civic responsibility exception. On the other hand, creating what would effectively be a two tiered analysis would muddy an already complex jurisprudence, so the Court might well prefer to stick with a bright line rule wherein the state or municipality is excepted from negative Commerce Clause scrutiny as long as the law “favors a traditional government function without any differential treatment favoring local entities over substantially similar out-of-state interests;” whether there is a less “discriminatory” alternative available should not be relevant. *Id.* at 1811.

165. *Id.* at 1830 (Kennedy, J., dissenting). Justice Kennedy went on to say that the Court’s opinion will risk “further dislocations and market inefficiencies based on the origin of products and commodities that should be traded nationwide and without local trade barriers.” *Id.* Unfortunately, Justice Kennedy never pointed out where the market inefficiency was in differential taxation for municipal bonds, and he never explained why municipal bonds should be traded nationwide without “barriers.” The evidence suggested that with regard to municipal bonds, the differential tax system works well. See *supra* notes 100–103 and accompanying text.

166. *Davis*, 128 S. Ct. at 1830 (Alito, J., dissenting).

167. *Id.* In *United Haulers*, Justice Alito reasoned that the regulations challenged were essentially the same as those which had been challenged in *Carbone*, and therefore he saw no reason to reach a

V. IMPACT OF THE COURT'S DECISION

A. Legal Impact

The legal importance of *Davis* should not be understated. With Justice Souter's statement that "Kentucky's tax exemption favors a traditional government function without any differential treatment favoring local entities over substantially similar out-of-state interests," the Court further entrenched the new civic responsibility exception first applied in *United*

different result. *United Haulers Ass'n, v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1803 (2007) (Alito, J., dissenting). He stated that "[t]he Court relies on the distinction between public and private ownership to uphold the flow-control laws, even though a straightforward application of *Carbone* would lead to the opposite result." *Id.* at 1804. Justice Alito may have viewed *Carbone* as already deciding the public-private issue in a way that found no meaningful distinction for negative Commerce Clause analysis between privately-owned and publicly-owned facilities. For example although recognizing that the Court claimed the facility in *Carbone* was privately owned, Justice Alito challenged that assertion in *United Haulers* and stated it was misleading to call that facility privately-owned. *Id.* The facts of *Carbone* show that under the arrangement between the city of Clarkstown and a private contractor, the contractor promised to build a waste transfer station at a cost of \$1.4 million. *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 387 (1994). In exchange, the city promised that it would ensure by means of a local flow control ordinance that the facility received 120,000 tons of waste per year and that the contractor would be able to charge haulers eighty-one dollars per ton of waste. *Id.* At the end of five years, the city would then purchase the facility from the contractor for one dollar. *Id.* Justice Alito made much of the fact that the Court stated "[t]he town would finance its new facility with the income generated by the tipping fees." *Id.* (emphasis added). Indeed, he stated that "[t]he only real difference between the facility at issue in *Carbone* and its counterpart in this case is that title to the former had not yet formally passed to the municipality." *United Haulers*, 127 S. Ct. at 1804 (Alito, J., dissenting). In his dissent in *Carbone*, Justice Souter first brought up the public-private distinction and argued that the facility was essentially public because it "directly aids the government in satisfying a traditional governmental responsibility" and therefore the flow control ordinance should not violate the negative Commerce Clause. *Carbone*, 511 U.S. at 411 (Souter, J., dissenting). Chief Justice Roberts, in his opinion for the Court in *United Haulers*, noted that the majority in *Carbone* did not comment on Justice Souter's dissenting distinction between public and private entities. *United Haulers*, 127 S. Ct. at 1793. He suggested that the majority's silence as to the dissent's discussion of the public-private distinction could be viewed in one of two ways. *Id.* First, it could be interpreted as the majority thinking that negative Commerce Clause jurisprudence would remain the same whether a public or a private facility was at issue. *Id.* Second, the majority's silence could be viewed as the Court avoiding the issue because it considered the facility in *Carbone* to be private, and therefore the issue was not properly before the Court. *Id.* at 1793-94. Chief Justice Roberts and the Court in *United Haulers* adopted the second interpretation, noting that Justice Souter had provided numerous reasons in his dissent why a public facility should be treated differently from a private facility and that it would be extremely odd for the Court to reject such an argument without comment. *Id.* at 1794; see *supra* note 63 and accompanying text. Justice Alito was unable to refute this argument. Instead, he attempted to rewrite the majority's intent in *Carbone*, saying that the majority clearly agreed with the dissent that the facility was public, but that this fact simply did not make a difference in its analysis. *United Haulers*, 127 S. Ct. at 1805. But, as Chief Justice Roberts noted, if the majority in *Carbone* agreed with the dissent that the facility was in fact public, it would be almost inconceivable for the Court to have somehow rejected the dissent's argument that such a distinction matters for negative Commerce Clause purposes without ever saying so. *Id.* at 1794.

Haulers.¹⁶⁸ *Davis* succeeded in providing some clarity regarding the new exception. First, the civic responsibility exception can be widely applied.¹⁶⁹ Second, there is no need for the government to monopolize an industry or sector in order for a challenged law to fit within the exception.¹⁷⁰ However, while *Davis* helped to clarify *United Haulers*, it failed to fully delineate the scope of the civic responsibility exception.¹⁷¹ While it appears that a state or

168. *Davis*, 128 S. Ct. at 1811. Chief Justice Roberts laid out the first formulation of the rule in *United Haulers*. He stated that “laws that favor the government in such areas [traditional government activities]—but treat every private business, whether in-state or out-of-state, exactly the same—do not discriminate against interstate commerce for purposes of the Commerce Clause.” *United Haulers*, 127 S. Ct. at 1790.

169. Both *Carbone* and *United Haulers* dealt with the government’s civic responsibility to provide for waste management. *United Haulers*, 127 S. Ct. at 1790; *Carbone*, 511 U.S. at 387. However, *Davis* makes it clear that States and municipalities are immune from the talons of the negative Commerce Clause whenever they are providing for the health, safety and welfare of their citizens in a way that does not advantage private industry. *Davis*, 128 S. Ct. at 1811. In addition, the holding in *Davis* suggests that what might normally appear to be discrimination against other states is not discrimination for the purposes of the negative Commerce Clause, which is certainly an expanded understanding in comparison to *United Haulers*. Professor Williams asserts that the wide application of the civic responsibility exception is judicial error. Williams, *supra* note 91, at 467. He suggests that the *United Haulers* Court wanted to find the flow control ordinance constitutional, but, seeing that such a holding could not be made under the Court’s current jurisprudence, simply concocted a new test such that the scheme could be found nondiscriminatory. *Id.* Due to *United Haulers*, he claims that the Court in *Davis* “was left with no option but to uphold” the differential taxation scheme, suggesting the Court is now at the mercy of the exception it unwittingly created. *Id.* Although Professor Williams’s article is otherwise enlightening, his analysis seems hollow here. His claim essentially boils down to an argument in which the Court in *United Haulers* wanted so badly to find the ordinance nondiscriminatory that it was willing to do anything, including creating an entirely new doctrine just to fulfill its purpose in that one case. If the Court had indeed created an entirely new doctrine just to allow a couple of counties in New York to control their own waste, it could have easily distinguished *Davis* on numerous other grounds and continued to do the same with similar cases in the future, so as to prevent the entrenchment of the civic responsibility exception and thereby contain the holding to *United Haulers*. See *Davis*, 128 S. Ct. at 1827 (Kennedy, J., dissenting) (suggesting that a monopoly is required for the civic responsibility exception to apply). Professor Williams also suggests the Court has set the country on a slippery slope in which states will be able to force all children to attend public schools or force all private businesses to purchase cement from a state-owned cement facility. Williams, *supra* note 91, at 468. However, as he goes on to note, the Court has already invalidated such violations of individual rights. *Id.* at 468 n.228 (citing *Pierce v. Soc’y of Sisters*, 268 U.S. 510 (1925)). In addition, he suggests that Congress is somehow incapable of legislating on such topics, ostensibly because it is too busy to be bothered with its own Constitutional duties, making Article III courts the better option. *Id.* at 468. Unfortunately, the Constitution does not provide Congress with the ability to delegate its legislating duties to the judiciary. As Chief Justice Roberts noted, “[r]ecognizing that local government may facilitate a customary and traditional government function such as waste disposal, without running afoul of the Commerce Clause, is hardly a prescription for state control of the economy.” *United Haulers*, 127 S. Ct. at 1797 n.7.

170. See *supra* note 148 and accompanying text.

171. The problem lies within the ambiguity of the rule fashioned by Chief Justice Roberts and Justice Souter. The rule is premised upon a governmental entity performing a traditional

municipality does not need to fall under the rubric of the market participant doctrine in order to meet the requirements of the civic responsibility exception, there remains some disagreement within the Court.¹⁷² Additionally, the outer limits of how far a state or municipality¹⁷³ may go to

government function. See *United Haulers*, 127 S. Ct. at 1790. Chief Justice Roberts easily found trash disposal to be a traditional government function. *Id.* Likewise, in *Davis*, Justice Souter spent little time arguing that the issuance of bonds was a traditional government function, noting that it was “a century-old . . . practice.” *Davis*, 128 S. Ct. at 1811. While trash disposal and providing funding through the issuance of bonds have clearly been government functions for decades, the problems are likely to arise at the fringes. For example, in *Garcia v. San Antonio Metropolitan Transit Authority*, Justice Blackmun wrote at length about the difficulty in defining a traditional government function. *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 538 (1985). He noted that the Court “find[s] it difficult, if not impossible,” to define what is and what is not a traditional government function. *Id.* at 539. Both Chief Justice Roberts and Justice Souter used a historical analysis to determine that trash disposal and the issuance of bonds were traditional government functions, but Justice Blackmun argued that there is great confusion with regard to historical analysis and that the Court “disclaimed a rigid reliance on the historical pedigree of state involvement in a particular area.” *Id.* at 540. He went on to note that “[t]he most obvious defect of a historical approach to state immunity is that it prevents a court from accommodating changes in the historical functions of States.” *Id.* at 543. Justice Alito picked up on this argument in his dissent in *United Haulers*, noting that, “to the extent [the] holding rests on a distinction between ‘traditional’ governmental functions and their nontraditional counterparts, . . . it cannot be reconciled with prior precedent.” *United Haulers*, 127 S. Ct. at 1810–11 (Alito, J., dissenting) (citation omitted). This point by Justice Alito is worthy of further investigation.

172. See *supra* notes 88–94 and accompanying text. Justice Souter’s addition of a market participant analysis to the facts in *Davis* seems odd, especially because he noted in the majority opinion that “[i]t follows *a fortiori* from *United Haulers* that Kentucky must prevail.” *Davis*, 128 S. Ct. at 1810. Having already decided that Kentucky must win because of the civic responsibility exception identified in *United Haulers*, Justice Souter argued that “[t]his case, like *United Haulers*, may also be seen under the broader rubric of the market participation doctrine.” *Id.* at 1811. (plurality opinion). However, *United Haulers* never considered the market participation doctrine, and Justice Souter offered no reason as to why it was necessary to apply it in *Davis*. Chief Justice Roberts appears to have convinced the Court that a market participation analysis is not necessary in a civic responsibility exception case. *Id.* at 1821 (Roberts, C.J., concurring) (“A majority of the Court shares this view.”).

173. The Court never explicitly stated that municipalities should fall under the civic responsibility exception as the states do, but it logically follows that they would. Technically, in both *United Haulers* and *Davis*, the statutes at issue were created by the respective states of New York and Kentucky. See *Davis*, 128 S. Ct. at 1804; *United Haulers*, 127 S. Ct. at 1791. However, in both cases local municipalities were involved in the alleged discrimination which the Court ultimately found to not be discrimination at all. There is a parallel with the market participation doctrine, which does apply to municipalities. In *White v. Massachusetts Council of Construction Employers*, the Court considered an executive order from the mayor of Boston which required that all construction projects paid for with any amount of city funds had to have a work force comprised of at least 50% Boston residents. *White v. Mass. Council of Constr. Employers*, 460 U.S. 204, 205–06 (1983). Then-associate Justice Rehnquist, writing for the Court, noted that the city easily qualified as a government entity under the market participant doctrine. *Id.* at 210 (“If the city is a market participant, then the Commerce Clause establishes no barrier to conditions such as these which the city demands for its participation. Impact on out-of-state residents figures in the equation only after it is decided that the city is regulating the market rather than participating in it, for only in the former case need it be determined whether any burden on interstate commerce is permitted by the Commerce Clause.”).

provide for the health, safety, and welfare of its citizens will have to be defined in future cases.

Due to the lack of clarity with regard to the civic responsibility exception's scope, uncertainty about the constitutionality of tax-exempt private activity bonds will linger.¹⁷⁴ As noted earlier, Justice Souter declined to discuss whether state tax exemptions for in-state private activity bonds violate the negative Commerce Clause.¹⁷⁵ Assuming *Camps Newfound* and *Carbone* are still good law—and based upon *United Haulers* and *Davis*, there is no reason to believe otherwise—the Court should hold that a differential taxation scheme for private activity bonds violates the negative Commerce Clause.¹⁷⁶ However, until the Court has the opportunity to confront this issue, confusion will reign in the bond market.¹⁷⁷

174. See *supra* note 75 and accompanying text. Under the Internal Revenue Code, a private activity bond is a bond from which, “(1) more than 10% of the proceeds are to be used by any private business, and (2) more than 10% of principal or interest on the bonds is repaid from, or secured by, private business money or property.” Michael Livingston, *Reform or Revolution? Tax-Exempt Bonds, the Legislative Process, and the Meaning of Tax Reform*, 22 U.C. DAVIS L. REV. 1165, 1207 (1989). Private activity bonds “are issued to provide governmental financing to non-governmental entities or persons conducting activities that the state legislature has determined serve a public purpose.” Brief for the National Federation of Municipal Analysts, *supra* note 102, at 6.

175. See *supra* note 75 and accompanying text. Some in the academic community have declined to even opine an opinion as to how the Court will eventually decide the issue, as the analysis remains muddled. See *Dormant Commerce Clause*, *supra* note 11, at 285 (“[T]he analysis of the tax treatment of private activity bonds is complicated by the presence of private entities acting as intermediaries between the government and the creation of public goods, and thus it is unclear how the Court will rule when and if it is faced with a constitutional challenge to that differential tax treatment.”).

176. There is no doubt that private activity bonds do benefit local populations. They often fund a number of important facilities and projects including:

[F]ederally-insured or state-authorized student loans for higher education; low-income or mixed-income housing; hospitals, nursing homes, assisted living and other health care facilities; schools, colleges, and universities; museums; social services agencies; solid waste disposal facilities; airports; docks and wharves; mass commuting facilities; sewage facilities; facilities for the furnishing of water or the local furnishing of electric energy or gas; local district heating or cooling facilities; hazardous waste facilities; high-speed intercity rail facilities; environmental enhancements of hydroelectric generating facilities; small manufacturing facilities and so-called “Liberty Bonds” issued to rebuild the areas devastated by the 9/11 terrorist attacks.

Brief for the National Federation of Municipal Analysts, *supra* note 102, at 6. While the tax exemptions for the bonds help to build projects that eventually lead to a public benefit, the Court's jurisprudence indicates that such an indirect public benefit might not be enough for negative Commerce Clause purposes. Consider *Camps Newfound*, where the Court invalidated the Maine statute providing tax exemptions for charities that favored in-state residents. *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 568–71 (1997). Justice Scalia argued in his dissent that the “tax exemption, which excuses from taxation only that property used to relieve the State of its burden of caring for its residents, survives even our most demanding Commerce Clause scrutiny.” *Id.* at 595–96 (Scalia, J., dissenting). As Justice Scalia noted, providing such an

Yet, *Davis* did more than help entrench and expand a new exception to the negative Commerce Clause. Justice Souter's opinion in *Davis* shows that the battle against retaining *Pike* balancing as part of the Court's negative Commerce Clause jurisprudence remains ongoing.¹⁷⁸ Specifically, the Court has shown a complete unwillingness to even engage in balancing when confronted with an economic issue.¹⁷⁹ While *Pike* technically remains a part

exemption would not "place the 'national market' in any peril." *Id.* at 601 n.1. Certainly the tax exemption for charitable non-profits is very similar in effect to private activity bonds for organizations and projects, in that both help a state to fulfill its civic responsibilities. However, the majority disagreed with Justice Scalia in *Camps Newfoundland*, arguing that the case was simply one of protectionism and that Congress would be the more appropriate body to make such an exception. *Id.* at 588. *Carbone* is also instructive. Although the Court did not cast its decision in terms of the public-private distinction, the arrangement in *Carbone* was in many ways similar to a private activity bond. The government offered a contractor a benefit (the flow control ordinance for five years) in exchange for building a facility that helped relieve the city of its civic responsibilities. *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 386-87 (1994). Likewise, a private activity bond offers a builder/organization a benefit (lower interest rates on bonds through tax exemptions) in exchange for building something that helps relieve a city or state of its civic responsibilities. The Court in *Carbone* rejected the ordinance because "[t]he Commerce Clause presumes a national market free from local legislation that discriminates in favor of local interests." *Id.* at 393. A private activity bond does not neatly fit into Chief Justice Roberts's formulation of the civic responsibility exception in that the Court specifically referenced that it was the *government* which the law must directly favor. *United Haulers*, 127 S. Ct. at 1790 ("[L]aws that favor the government in such areas—but treat every private business, whether in-state or out-of-state, exactly the same—do not discriminate against interstate commerce . . ."). The purpose of the private activity bond is to favor an entity *other than the government*. There is a corollary with the market participant doctrine, the Court's other main exception to the negative Commerce Clause. In *South-Central Timber Development, Inc. v. Wunnicke*, Justice White penned a very influential plurality. *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 97 (1984) (White, J., plurality). He noted that the Court had previously decided that, "[t]he market-participant doctrine permits a State to influence 'a discrete, identifiable class of economic activity in which [it] is a major participant.'" *Id.* (quoting *White v. Mass. Council of Constr. Employers, Inc.*, 460 U.S. 204, 211 n.7 (1983)). Justice White then stated that, "[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." *Id.* at 97. Therefore, a state cannot enact downstream regulation that allows it to control the market indirectly. *See id.* Based upon the general contours of the market participant doctrine, in which the *government* must be the actor, and upon the holdings of *Camps Newfoundland*, *Carbone*, and *United Haulers*, the Court should find that private activity bonds violate the negative Commerce Clause and are not saved by the civic responsibility exception.

177. *See Dormant Commerce Clause*, *supra* note 11, at 286 ("Market participants likely will (and should) remain conscious of the continued susceptibility of a significant portion of the municipal debt market to a constitutional challenge because an upheaval in the private activities bond market would have far-reaching and detrimental economic consequences in an already volatile market environment.").

178. *See supra* notes 104-109 and accompanying text.

179. Justice Souter cited to *General Motors v. Tracy* for the generally accepted proposition that the Court is not well suited to make economic decisions. *Davis*, 128 S. Ct. at 1818 (citing *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 281-82 (1997)). In *Tracy*, the Court considered an Ohio statute which imposed the state's "general sales and use taxes on natural gas purchases from all sellers, whether in-state or out-of-state, except regulated public utilities that meet Ohio's statutory definition of a 'natural gas company.'" *Tracy*, 519 U.S. at 281-82. In deciding the negative Commerce Clause claim, the Court stated that it was ill-qualified to make judgments about economic effects due to a lack of training, resources, and available information. *Id.* at 308-09. Justice Souter

of the Court's negative Commerce Clause jurisprudence, it might as well be gone—the Court has not invalidated a law by utilizing *Pike* since 1982.¹⁸⁰

B. Broad Impact

The immediate result of *Davis* is that states can continue to sell bonds at a reduced interest rate by utilizing a differential income tax scheme. Although states may actually lose money by utilizing this form of financing,¹⁸¹ it remains vitally important as a way to finance projects over time¹⁸² and to help smaller municipalities get funding for important local projects.¹⁸³ The upheaval of the current municipal bond system would have

closed by noting that “[t]he Constitution gives [Congress] the power to regulate commerce among the states, and until it acts I think we should enter the field with extreme caution.” *Id.* at 310 (quoting *Nw. Airlines, Inc. v. Minnesota*, 322 U.S. 292, 302 (1944) (concurring opinion)). Given that *Pike* is only applied when analyzing a case under the negative Commerce Clause, and many negative Commerce Clause cases deal with heady economic issues, it seems fair to say *Pike* retains extremely little utility. However, when the Court does want to analyze under *Pike*, it simply avoids a discussion of economics in the balancing analysis. For example, in *United Haulers*, Chief Justice Roberts, in a plurality part of the opinion, discussed *Pike* balancing, but kept the discussion couched in terms of the prospective health and environmental benefits while largely avoiding an in-depth discussion of the degree to which the ordinance was simply a financing measure. *United Haulers*, 127 S. Ct. at 1797 (Roberts, C.J., plurality).

180. David S. Day, *The “Mature” Rehnquist Court and the Dormant Commerce Clause Doctrine: The Expanded Discrimination Tier*, 52 S.D. L. REV. 1, 50 (2007) (“Another remarkable feature of the end of the Rehnquist Court was that, although the doctrine had two tiers, the Court had chosen to decide cases only on the discrimination tier. The nondiscrimination tier [*Pike*] had fallen into rather obvious non-use.”). The last law invalidated under *Pike* was in the 1982 case *Edgar v. MITE Corp.* *Edgar v. MITE Corp.*, 457 U.S. 624 (1982); Donald H. Regan, *Siamese Essays: (1) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (2) Extraterritorial State Legislation*, 85 MICH. L. REV. 1865, 1868 n.18 (“In *Edgar v. MITE Corp.* there was one brief section of White’s opinion, the section on *Pike*-based balancing, that received five votes and thereby became technically the opinion of the Court.” (citation omitted)). In *Edgar*, MITE challenged an Illinois statute that required target companies (takeover candidates which had at least ten percent of their shares owned by Illinois shareholders) to register any takeover offer with the Illinois Secretary of State. *Edgar*, 457 U.S. at 626–27. While the statute was not per se discriminatory, the Court ruled that the “burden the Act imposes on interstate commerce is excessive in light of the local interests,” because the Illinois Secretary of State effectively had the power to block a nationwide tender offer. *Id.* at 640–43.

181. The brief for the states notes that when a state enacts a differential income tax on municipal bonds, it misses out on tax revenues it otherwise would have received. Brief for the States, *supra* note 5, at 2–3.

182. Attaway, *supra* note 1, at 740–41 (“Although states could use general tax revenues to finance capital projects, they tend instead to use debt in order to spread the costs of capital projects across all those who will benefit from them over time.”).

183. See *supra* notes 100–103 and accompanying text.

wreaked havoc on states' financing at a time when budgets across the country are already in dire trouble.¹⁸⁴

However, the confusion with regard to private activity bonds remains troubling. If tax exemptions for private activity bonds are found to be unconstitutional, the projects they usually fund could have severe trouble gaining alternative financing.¹⁸⁵ This could create substantial upheaval in the bond market and further damage the economy.

Additionally, the broad impact of this decision should not be couched in merely financial terms. This decision also allows states to become more active in seeking solutions to their citizens' problems.¹⁸⁶ States will regain confidence in their role as experimenters within the federal system.¹⁸⁷ Ideas

184. See Brief for the States, *supra* note 5, at 1. The states argued that if Kentucky had lost the case there would have been, "staggering potential liability." *Id.* This was because of claims which citizens would make against the states demanding that their taxes be refunded and because of the loss of revenue from taxing out-of-state bonds going forward. *Id.* For example, New York alone estimated that it would owe \$200 million in refunds to its taxpayers. *Id.* at 17. The states would not be able to remedy the problem by retroactively taxing citizens who had not previously paid tax on in-state bonds because of both constitutional and political issues. *Id.* at 16–17 (noting that "numerous States have state constitutional provisions that preclude their legislature from taxing their own State's bonds").

185. See *supra* notes 174–177 and accompanying text.

186. One such experiment was started by the State of New York in 1997. Amy Remus Scott, *A Commerce Clause Challenge to New York's Tax Deduction for Investment in Its Own Tuition Savings Program*, 32 U. MICH. J.L. REF. 379, 380 (1999). Pursuant to Section 529(b) of the Internal Revenue Code, states can create qualified state tuition programs, which exempt all non-distributed earnings from federal income taxation. *Id.* at 379–80. New York created such a program and allowed a state tax deduction for some of the money contributed to its plan but did not allow a deduction for money contributed to the plans of other states. *Id.* at 381. The author argued that the plan was a clear violation of the negative Commerce Clause. *Id.* at 382. While this was a reasonable conclusion at the time the article was written in 1999, it is clear that the conclusion is no longer correct. New York's tuition savings program is based on an extremely similar model to a differential income tax for in-state municipal bonds. The key here is that the state is favoring a traditional government function, which education most certainly is, and doing so in a manner without treating in-state and out-of-state private interests differently. Prior to *Davis*, there may have been an argument that the program was still discriminatory because it favored New York's program over the programs created by other states; however *Davis* makes clear that for negative Commerce Clause purposes, when states are engaging in traditional government functions, the only requirement is that they treat in-state and out-of-state private interests the same. See Brief for the States, *supra* note 5, at 32.

187. Many still consider the states' role as experimenters within the federalist system to be vital. For example, William H. Pryor Jr., Circuit Judge, United States Court of Appeals for the Eleventh Circuit, argues that "[w]hen the states are allowed to experiment, regulatory failures can be confined to smaller communities and contrasted with regulatory successes. A regulatory failure on a national scale, instead of a failure confined to a state, reveals the risk of tyranny that federalism prevents." William H. Pryor Jr., *Federalism and Freedom*, 83 TUL. L. REV. 585, 590 (2008) (reviewing ERWIN CHERMERINSKY, *ENHANCING GOVERNMENT: FEDERALISM FOR THE 21ST CENTURY* (2008)). Certainly, the civic responsibility exception which the Court has outlined allows states the opportunity to conduct the very kinds of regulatory experiments to which Judge Pryor refers. If a state is successful, other states can adopt the regulation. If the state fails, the problem is confined to only one of the fifty states. Judge Pryor thus went on to note that "[w]hen I proposed laws as a state attorney general, I often surveyed the laws of other states to learn what worked and what policy

that work can be adopted by other states, just as New York's differential tax scheme for municipal bonds has been adopted by other states seeking flexible financing options for large projects.¹⁸⁸

VI. CONCLUSION

Davis, in tandem with *United Haulers*, marks the first significant change to the Court's negative Commerce Clause analysis since the introduction of *Pike* nearly forty years ago. However, the impact of *Davis* may not be fully realized for many years. The Court has shown an increasing tendency to shy away from invalidating laws under the negative Commerce Clause, and the new civic responsibility exception shows that there is growing support in the Court to attack the doctrine in piecemeal fashion.

Advocates of states' rights will claim victory in *Davis*, but the opinion should not be read so narrowly. Far from lessening the power of the federal government over the states, the Court merely noted the importance of states having the capacity to act when Congress does not dictate otherwise. In so doing, the Court merely reaffirmed which branch should regulate state action in the commercial sphere, as nothing in the opinion restricts Congress's ability to regulate state waste disposal methods, state differential income tax laws, or any other traditional government function.

Although a great deal remains unsettled, this much is clear—the states, with their newly found freedom to act, can once again become the great experimenters the founders envisioned they would be. As Justice O'Connor once stated, such freedom allows “for the possibility that ‘a single courageous State may, if its citizens chose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.’”¹⁸⁹

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would best suit my state.” *Id.* at 592.

188. Judge Pryor notes that he “know[s] from experience that state competition and experimentation is a real and beneficial phenomenon.” Pryor, *supra* note 187, at 592–93.

189. *Gonzales v. Raich*, 545 U.S. 1, 42 (2005) (O'Connor, J., dissenting) (quoting *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)).

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