DaimlerChrysler Corp. v. Cuno, State Investment Incentives, and the Future of the Dormant Commerce Clause Doctrine

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Introduction

In *DaimlerChrysler Corp. v. Cuno*,[1] one of the 2005 term's closely-watched cases, the Supreme Court declined to decide whether tax incentives commonly used by states and municipalities to attract corporate investment violated the dormant Commerce Clause doctrine (DCCD). In a unanimous opinion by Chief Justice Roberts, the Court held that the state taxpayer plaintiffs in the case did not have standing to challenge the franchise tax credit offered by Ohio to manufacturers who made certain capital investments in the state.[2] The decision means that the case will be returned to the Ohio state courts, where it was initially brought by the plaintiffs. Thus, U.S. Supreme Court review of the merits of the case—if any—will have to await further litigation.

The outcome was anticipated,[3] even welcomed,[4] by legal scholars. But *Cuno*, along with another closely-watched case from North

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[1]126 S. Ct. 1854 (2006).

[2]*Id*. at 1865.

[3]See, e.g., Kristin E. Hickman, How Did We Get Here Anyway?: Considering the Standing Question in DaimlerChrysler v. Cuno, 4 Geo. J.L. & Pub. Pol'y 47 (2006); Kristin E. Hickman & Donald B. Tobin, Taxpayer Standing and DaimlerChrysler v. Cuno: Where Do We Go From Here?, Tax Notes, Feb. 20, 2006, at 863.

[4]See, e.g., Brannon P. Denning, Cuno and the Court: The Case for Minimalism, 4 Geo. J.L. & Pub. Pol'y 33 (2006) (urging the Court to write a ''minimalist'' opinion; suggesting that a decision disposing of the case on standing would be one option open to the Court).

Carolina that was dismissed on standing grounds,[5] sti[illegible]e constitutional status of state tax incentives in doubt. [illegible] a difficult case, I argue here, because the case exposed the difficulty the Court has had defining ''discrimination'' in DCCD cases. Cases like *Cuno* will continue to bedevil courts unless the Supreme Court clarifies what it means when it says that the DCCD is primarily concerned with eliminating state laws that discriminate against out-of-state goods or out-of-state economic actors.

In the pages that follow, I will summarize the litigation that led to the Court's decision and offer predictions as to what the future holds for DCCD challenges to state tax incentives. In particular, I will sketch some possibilities for clarifying the concept of discrimination in DCCD cases. There is much at stake. The DCCD has provided a measure of economic and political union among the states since its inception. The prohibition against discrimination is the most important doctrinal branch of the DCCD. But courts must clearly distinguish between discrimination of the sort that the Framers sought to eliminate and healthy competition among states. If they do not—if every effort states make to structure their tax code in ways that make them attractive to out-of-state businesses is subject to judicial review by federal courts, then the more persuasive arguments for the DCCD's abandonment will seem.[6]

I. *Cuno*: The Court's Holding

Ohio offered a franchise tax credit for taxpayers purchasing manufacturing machinery and equipment and installing it in the state.[7] Cities were also authorized to offer property tax waivers to businesses that invest in particular areas of the state.[8] DaimlerChrysler

[5] See Patrick Hogan, Judge Dismisses Dell Incentive Case, Austin Bus. J., May 10, 2006, available at http://www.bizjournals.com/austin/stories/2006/05/08/daily34.html.

[6] See, e.g., Edward A. Zelinsky, Cuno v. DaimlerChrysler: A Critique, 34 St. Tax Notes 37 (Oct. 4, 2004); Edward A. Zelinsky, Restoring Politics to the Commerce Clause: The Case for Abandoning the Dormant Commerce Clause Prohibition on Discriminatory Taxation, 29 Ohio N.U.L. Rev. 29 (2002).

[7] Ohio Rev. Code Ann. § 5733.33(B)(1) (1999).

[8] *Id.* §§ 5709.62(C), (D)(1). The Court noted, however, that Ohio has begun phasing out its franchise tax and has begun discontinuing the credits like that given to DaimlerChrysler. DaimlerChrysler Corp. v. Cuno, 126 S. Ct. 1854, 1859 n.1 (2006).

received the benefit of both when, in 1998, the company [illegible] to expand a Jeep assembly plant located in Toledo.[9] A group of taxpayers represented by Northeastern law professor Peter Enrich[10] sued in state court, claiming that the incentives violated the DCCD. DaimlerChrysler removed the case to federal district court and won.[11] On appeal, the Sixth Circuit agreed that the property tax exemption was constitutional, but struck the franchise tax exemption on the ground that it ''coerced'' DaimlerChrysler into locating its manufacturing equipment in the state.[12]

The plaintiffs had opposed removal to federal court, fearing an inability to satisfy standing requirements.[13] The district court disagreed,[14] holding that the taxpayers had standing to object to the property tax exemption and the franchise tax credit based on *Massachusetts v. Mellon*.[15] The Sixth Circuit's opinion did not even mention the standing issue. Even so, many observers thought that plaintiffs still faced considerable hurdles on the standing question, and when the Supreme Court requested briefing on the issue when it granted cert.,[16] it seemed the Court was setting the stage for dismissal on those grounds. In an opinion by Chief Justice John Roberts,[17] the Court did just that, unanimously concluding that the plaintiffs had no standing to challenge the franchise tax credit.[18]

[9]Cuno, 126 S. Ct. at 1859.

[10]Professor Enrich had written an article laying out the argument for challenging tax credits like those offered by Ohio. See Peter Enrich, Saving the States from Themselves, 110 Harv. L. Rev. 377 (1996).

[11]See Cuno v. DaimlerChrysler, 154 F. Supp. 2d 1196 (N.D. Ohio 2001).

[12]Cuno v. DaimlerChrysler Corp., 386 F.3d 738, 745–46 (6th Cir. 2004).

[13]126 S. Ct. at 1860.

[14]*Id.*

[15]262 U.S. 447 (1923).

[16]DaimlerChrysler Corp. v. Cuno, 126 S. Ct. 36 (2005).

[17]Justice Ginsburg concurred in the result and in part of the rationale. She explained that the decision ''is solidly grounded in longstanding precedent . . . decisions that antedate current jurisprudence on standing to sue. . . . One can accept . . . the nonjusticiability of . . . federal and state taxpayer suits in federal court without endorsing as well the limitations on standing later declared in'' the Court's later cases. 126 S. Ct. at 1868–69 (Ginsburg, J., concurring) (citations omitted).

[18]The Court granted cert. only on the franchise tax exemption. The plaintiffs abandoned arguments that they were injured because they were displaced by DaimlerChrysler's expansion and also abandoned arguments by Michigan residents that, but for the Ohio incentives, DaimlerChrysler would have expanded in Michigan, bringing attendant benefits. *Id.* at 1859.

The opinion began with testimony to the importance of standing and its relation to Article III's limitation of the federal judiciary's jurisdiction to decide ''Cases and Controversies.''[19] That limitation, the Court explained, ensured that the federal judiciary did not trespass on the domain of the other branches; standing doctrine reinforces the case-or-controversy requirement by requiring litigants to allege concrete injuries traceable to the defendant's conduct and likely to be redressed by the relief requested.[20]

In general, the Court has held that federal and state taxpayers challenging governmental action they allege to be unconstitutional *do not* have the kind of injury necessary to confer standing.[21] Taxpayers, the Court has held, do not have a ''concrete and particularized'' injury, but rather a ''generalized'' injury common among all taxpayers.[22] The only exception the Court has recognized to this general rule involves the taxing and spending decisions allegedly made in violation of the Establishment Clause.[23]

The *Cuno* plaintiffs alleged that tax credits depleted funds available to the state, funds to which the plaintiffs as taxpayers contributed, and imposed additional burdens on taxpayers since they would likely have to pick up the tab.[24] But the Court noted that this alleged injury was not ''concrete and particularized,'' and, furthermore, it was not even clear that there would actually *be* any injury. ''The very point of the tax benefits is to spur economic activity, which in turn *increases* revenue.''[25]

Moreover, the alleged injury was pure conjecture, because it depended ''on how legislators respond[ed] to a reduction in revenue, if that is the consequence of the credit. Establishing injury requires

[19] U.S. Const. art. III; Cuno, 126 S. Ct. at 1860–61.

[20] 126 S. Ct. at 1861 (citing Allen v. Wright, 468 U.S. 737, 751 (1984)).

[21] See Doremus v. Board of Education, 342 U.S. 429 (1952) (standing of state taxpayers); Frothingham v. Mellon, 262 U.S. 447 (1923); see also Cuno, 126 S. Ct. at 1861–63 (discussing cases). See generally Hickman, *supra* note 3, at 54–56 (summarizing the doctrine).

[22] Cuno, 126 S. Ct. at 1862 (internal quotation marks omitted).

[23] Flast v. Cohen, 392 U.S. 83 (1968).

[24] 126 S. Ct. at 1862.

[25] *Id.* The Court noted that the out-of-state plaintiffs ''claimed they were injured because they lost out on the added revenues that would have accompanied DaimlerChrysler's decision to expand facilities in Michigan.'' *Id.*

speculating that elected officials will increase a taxpayer's tax bill to make up a deficit . . . .''[26] Likewise, ''establishing redressability requires speculating that abolishing the challenged credit will redound to the benefit of the taxpayer because the legislators will pass along the supposed increased revenue in the form of tax reductions.''[27] Both, the Court continued, are fundamental policy matters over which the Court may have no say.[28] ''Under such circumstances,'' Chief Justice Roberts continued, ''we have no assurance that the asserted injury is 'imminent'—that it is 'certainly impending.'''[29]

The Court held that the concerns militating against granting standing to federal taxpayers applied to state taxpayers as well, reiterating the Court's holding in *Doremus v. Board of Education*.[30] Like the federal government, ''[s]tate policymakers . . . retain broad discretion to make 'policy decisions' concerning state spending'' and ''[f]ederal courts may not assume a particular exercise of this state fiscal discretion in establishing standing . . . .''[31] To hold otherwise would commit to the federal courts broad supervisory powers over a vast array of state taxing and spending decisions ''contrary to the more modest role Article III envisions for federal courts.''[32]

The Court further rejected plaintiffs' arguments that the Establishment Clause exception to the taxpayer standing rule recognized in *Flast v. Cohen*[33] be expanded to cover DCCD challenges.[34] ''[A] finding that the Commerce Clause satisfies the *Flast* test would leave no principled way of distinguishing those other constitutional provisions that we have recognized constrain government's taxing and spending decisions.''[35] This, in turn, would open federal courts up

[26] *Id.* at 1862–63.

[27] *Id.* at 1863.

[28] *Id.*

[29] *Id.*

[30] 342 U.S. 429 (1952).

[31] 126 S. Ct. at 1863–64.

[32] *Id.* at 1864.

[33] 392 U.S. 83 (1968).

[34] 126 S. Ct. at 1864–65.

[35] *Id.* at 1865.

to the sorts of generalized grievances prohibited by the case-or-controversy requirement.

Finally, the Court refused to allow the plaintiffs to invoke their status as *municipal* taxpayers to challenge a state action. The plaintiffs claimed that since Ohio law required the franchise tax revenue to be distributed to municipalities, the credits reduced those amounts and, again, depleted the municipal funds to which taxpayers contributed.[36] The plaintiffs also argued that federal courts could hear their DCCD challenges, despite standing problems, because they had standing to challenge the property tax exemption for businesses that invest in particular areas of the state.[37] Plaintiffs relied on *United Mine Workers v. Gibbs*,[38] which authorizes supplemental jurisdiction over certain claims that arise from a ''common nucleus of operative facts.''[39]

As to the first, the Court noted that the plaintiffs' challenge ''is still to the state law and state decision, not those of their municipality.''[40] In any event, the problems of immediacy of the injury and its redressability were still present: Ohio had, since 2001, suspended the distribution of franchise tax revenues to local governments. ''Any effect that enjoining DaimlerChrysler's credit will have on municipal funds . . . will not result from automatic operation of a statutory formula, but from a hypothesis that the state government will choose to direct the supposed revenue from the restored franchise tax to municipalities.''[41]

Nor was the Court inclined to subscribe to the plaintiffs' capacious reading of *Gibbs*.[42] The Court stressed it had ''never . . . [applied] the rationale of *Gibbs* to permit a federal court to exercise supplemental jurisdiction over a claim that does not satisfy those elements of the

[36] *Id.*

[37] See *supra* note 8 and accompanying text.

[38] 383 U.S. 715 (1966).

[39] *Id.* at 725; 126 S. Ct. at 1866–68.

[40] 126 S. Ct. at 1866.

[41] *Id.*

[42] *Id.* (''Plaintiffs assume that *Gibbs* stands for the proposition that federal jurisdiction extends to all claims sufficiently related to a claim within Article III to be part of the same case, regardless of the nature of the deficiency that would keep the former claims out of federal court if presented on their own.'').

Article III inquiry'' like standing.[43] Were it to adopt the plaintiffs' view of *Gibbs*, the Court warned, nearly all of the Court's case-or-controversy doctrines would be eroded.[44] Since Article III was designed to maintain the judicial power within its proper boundaries, any interpretation of *Gibbs* that would undermine those limits cannot be the correct one.[45]

''Plaintiffs failed to establish Article III injury with respect to their *state* taxes,'' the Court concluded, and ''even if they did so with respect to their *municipal* taxes, that remedy does not entitle them to seek a remedy as to the state taxes.''[46]

II. The Dormant Commerce Clause Doctrine and Investment Incentives

In the short run, the Court was able to put off an extremely vexing question with its decision on standing. The disposition on standing was not, as mentioned, unexpected. In fact, just a few days before the Court announced its decision in *Cuno*, a North Carolina state court judge threw out a similar case brought by taxpayers challenging that state's provision of tax incentives to Dell Computer. According to the judge, the taxpayers had not proven injury sufficient to maintain standing.[47]

But the Supreme Court has, in all likelihood, simply postponed a decision on the merits, assuming that no congressional legislation is forthcoming. The Ohio plaintiffs are now free to pursue their case in Ohio's state courts where they originally brought it, and the U.S. Supreme Court is always free to review the decision of that state's high court. In this Part, I canvass the options that the Ohio courts have open to them when considering the constitutionality of the Ohio program under the DCCD. The next Part, however, suggests that *Cuno* seemed so difficult because the particular investment scheme highlighted difficulties with the entire concept of ''discrimination'' under the DCCD. Reframing that concept might clarify not

[43] *Id*. at 1867.

[44] *Id*

[45] *Id.* at 1868.

[46] *Id.*

[47] See Hogan, Judge Dismisses Dell Incentive Case, *supra* note 5.

only the underlying case in *Cuno*, but also aid in clearing up some doctrinal anomalies that persist in the DCCD generally.

A. A DCCD Primer

Courts apply the DCCD using a two-tier standard of review. For state and local laws or regulations that ''discriminate'' against interstate commerce on their face, or, if facially-neutral, in their purposes or effects, a form of strict scrutiny applies (hereinafter the ''anti-discrimination principle''). While a slightly different test obtains when the DCCD is applied to state and local taxes on interstate commerce, the anti-discrimination principle applies equally to both taxes and non-tax regulations. To survive judicial scrutiny, the government must prove that it is pursuing a legitimate (*i.e.*, non-protectionist) interest and that no less discriminatory means exist that allow it to pursue that interest. Few regulations survive this scrutiny. For those laws that are truly non-discriminatory, a more deferential test is applied—plaintiffs must prove that the burdens on interstate commerce ''clearly exceed'' the ''putative local benefits.''[48]

There are a few exceptions that bear mentioning. First, the Court has not, to date, applied the rules of the DCCD to discriminatory *cash* subsidies of in-state industries. If Alabama wishes to ladle cash out to preferred local industries, to the exclusion of their out-of-state competitors, it may do so. A second, related, exception—the *market-participant* exception—permits a state *acting as an ordinary buyer or seller in a particular market* (as opposed to a ''market regulator'') to favor local businesses. For example, if Alabama spent state funds to build a plant that manufactured widgets and, because of a national widget shortage, restricted sales to in-state widget consumers, the market-participant exception would allow it to do so. Conversely, Alabama may, by law, decide to spend state funds to purchase only in-state widgets. Finally, Congress may legislate affirmatively to permit states to pass laws that would otherwise be invalid under the DCCD—*e.g.,* permitting states to ban the import or sale of out-of-state widgets.[49]

[48]For a succinct introduction to the DCCD, see Dan T. Coenen, The Commerce Clause 216–223 (2004).

[49]See *id.* at 287–314 (discussing the exceptions to the DCCD in greater detail).

B. The DCCD and State Economic Incentives

Cuno is not the first DCCD challenge to state schemes designed to benefit the local economy. Many of the previous cases, though, involved rather clear facial discrimination between in-state and out-of-state economic activity. For example, in *Boston Stock Exchange v. State Tax Commission*,[50] the Court invalidated a New York law taxing out-of-state securities transactions more than those occurring in state.[51] ''The obvious effect of the tax,'' the Court wrote, was ''to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges.''[52]

A few years later, in *Maryland v. Louisiana*,[53] the Court invalidated a ''first-use'' tax equal to the state's severance tax on natural gas extracted offshore and pumped into Louisiana for processing.[54] The tax was designed both to mitigate damage to Louisiana's ''waterbottoms barrier islands, and coastal areas resulting from the introduction of natural gas into Louisiana from areas not subject to state taxation'' as well as ''to equalize competition between gas produced in Louisiana and subject to the state severance tax . . . and gas produced elsewhere not subject to a severance tax . . . .''[55] Because of the exemptions and credits provided for in the state act, however, ''Louisiana consumers of [Outer Continental Shelf] gas for the most part are not burdened by the Tax, but it does uniformly apply to gas moving out of the State.''[56] As a result of these exemptions and credits, ''the Louisiana First-Use Tax unquestionably discriminate[d] against interstate commerce in favor of the local interests . . . .''[57]

In a third case, *Westinghouse Electric Corp. v. Tully*,[58] the Court struck down a New York tax credit available to special entities

[50] 429 U.S. 318 (1977).

[51] *Id*. at 319–20.

[52] *Id.* at 331.

[53] 451 U.S. 725 (1981).

[54] *Id.* at 731 (''Since most States impose their own severance tax, it is acknowledged that the primary effect of the First-Use Tax will be on gas produced in the federal [Outer Continental Shelf] area and then piped to processing plants located within Louisiana.'').

[55] *Id.* at 732.

[56] *Id.* at 733, 756–57.

[57] *Id.* at 756.

[58] 466 U.S. 388 (1984).

(DISCs[59]) recognized under the Internal Revenue Code a[illegible]ed special tax treatment under the Code. In order to avoi[illegible] of state tax revenue *and* to avoid a tax policy that would create a disincentive for DISCs to form in and export from New York, the state enacted a franchise tax credit, which ''lowered the effective tax rate on the accumulated DISC income reflected in the consolidated return to 30% of the otherwise applicable franchise tax rate'' as long as the income was derived ''from export products 'shipped from a regular place of business of the taxpayer within [New York].'''[60]

The effect of the credit, found the Court, was to treat differently otherwise similarly situated parent corporations whose only difference was ''the percentage of their DISCs' shipping activities conducted from New York. This adjustment,'' the Court continued, ''has the effect of allowing a parent a greater tax credit on its accumulated DISC income as its subsidiary DISC moves a greater percentage of its shipping activities into the State of New York.''[61] Not only did the law provide an incentive to move activities to New York, it also ''penalize[d] increases in the DISC's shipping activities in other states.''[62]

Like the laws in *Boston Stock Exchange* and *Maryland v. Louisiana*, the Court found that the credit and its effects ''encouraged the development of local industry by means of taxing measures that imposed greater burdens on economic activities taking place outside the state than were placed on similar activities within the State.''[63] The Court also rejected New York's argument that the disallowance of tax credit, as opposed to imposing a higher tax, held any constitutional significance. ''The discriminatory economic effect of these two measures would be identical.''[64]

Other cases offer an important gloss on the exceptions to the general DCCD rules described above. For example, the Court has differentiated between provision of cash subsidies to local industries and subsidies effected through the tax codes—for example through

[59]DISC is an acronym for ''Domestic International Sales Corporation.'' *Id.* at 390.

[60]*Id.* at 393 (alteration in the original).

[61]*Id.* at 400.

[62]*Id.* at 401.

[63]*Id.* at 404.

[64]*Id.*

exemptions or credits offered to local, but not out-of-state businesses or products.[65] As Justice Scalia put it in *New Energy Co. of Indiana v. Limbach*, ''[d]irect subsidization of domestic industry does not ordinarily run afoul of [the anti-discrimination principle]; discriminatory taxation of out-of-state manufacturers does'' because ''[t]he Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace,'' but rather only that favoritism ''*in connection with the State's regulation of interstate commerce*.''[66]

In *Limbach*, though, the Court rejected arguments that the market-participant exception immunized the tax credit from strict scrutiny. While conceding that ''the tax credit scheme has the purpose and effect of subsidizing a particular industry, as do many dispositions of the tax laws,'' that did not ''transform it into a form of state participation in the free market.''[67] The Ohio law involved ''neither its purchase nor its sale of ethanol, but its assessment and computation of taxes—a primeval governmental activity.''[68]

Limbach and later decisions thus stand for the proposition that activity economists would consider identical is treated differently for DCCD purposes. A tax credit or exemption of $100 is the same to an entity as a direct payment of $100 from the state treasury. Similarly, even indirect subsidization, such as occurs under the market-participant exception when the state makes a decision to favor in-state interests in the purchase or sale of goods, is held to be impermissible when effected through a state's tax code.

C. Business Incentives and the DCCD: The View from the Academy

The Ohio tax credit challenged in *Cuno* ''grant[ed] a taxpayer a non-refundable credit against the state's corporate franchise tax if the taxpayer 'purchses new manufacturing machinery and equipment . . . [and] the new manufacturing machinery and equipment

[65] New Energy Co. v. Limbach, 486 U.S. 269, 278 (1988) (invalidating sales tax credit for ethanol produced in Ohio or in states offering reciprocal treatment for Ohio-produced ethanol).

[66] *Id.* (emphasis in original). See also Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) (invalidating tax exemption for locally-produced alcoholic beverage).

[67] New Energy Co., 486 U.S. at 277.

[68] *Id.* See also Camps Newfound/Owatonna v. Harrison, 520 U.S. 564 (1997) (rejecting similar argument).

are installed in [Ohio].'''[69] While the tax credit was av[illegible] a non-discriminatory basis to in-state and out-of-state fir[illegible]th Circuit concluded that it ''discriminate[d] against interstate economic activity by coercing businesses already subject to the Ohio franchise tax to expand locally rather than out-of-state.''[70] Though businesses locating machinery elsewhere will not face an *increase* in their tax burden, ''a competitor that invests out-of-state,'' plaintiffs pointed out, ''will face a comparatively higher tax burden because it will be ineligible for any credit against its Ohio tax.''[71] Apparently finding the case on all fours with prior Court cases, and rejecting the narrower reading of those cases offered by the defendants, the Sixth Circuit struck down the Ohio tax credit.[72] The question that arises, though, is whether the Court cases described above led ineluctably to the Sixth Circuit's decision invalidating the tax credit.

Not surprisingly, two contending views of the Court's cases were offered in *Cuno*. The plaintiffs' attorney, Peter Enrich, took the position that not only were specific cases sufficient to invalidate the Ohio tax credit, but further that the anti-discrimination principle articulated and applied in those cases should be broadly construed to prohibit ''the distorting effects of state policies on the national economy, rather than on their disparate impacts on competing businesses.''[73] Broadening the principle in this way would, argued Enrich, take account of ''the vital Commerce Clause concerns—the threat to the economic vitality of other states, the prospect of inefficient allocation of economic resources, and the specter of rising interstate hostility'' that ''have . . . received less attention'' in the Court's decisions.[74] Applying the anti-discrimination principle in that way could result in the invalidation of a wide variety of heretofore unquestioned means by which state and local governments encourage businesses to locate, expand, or remain in a given area. This raises the specter of giving federal judges veto power over state

[69]Cuno v. DaimlerChrysler Corp., 386 F.3d 738, 741 (6th Cir. 2004) (quoting Ohio Rev. Code Ann. § 5733.33(B)(1) (alteration in the original)).

[70]*Id.* at 743.

[71]*Id.*

[72]*Id.* at 746.

[73]Enrich, *supra* note 10, at 454.

[74]*Id.* at 449.

and local taxing and spending programs.[75] It would see[illegible] the distinction the Court currently maintains between [illegible] direct subsidies. It might even call into question the validity of the market-participant doctrine, if buying or selling by state and local governments would result in ''economic distortion.''

That said, there is language in the Court's opinions that hints at such a broad conception of the anti-discrimination principle. In *Boston Stock Exchange*, for example, Justice White's opinion mentioned, as an objection to the New York tax, that it ''foreclose[d] tax-neutral decisions'' about where the securities transfers should take place.[76] He noted that the Court '''has viewed with particular suspicion state statues requiring business operations to be performed in the home State that could be more efficiently performed elsewhere.'''[77] Later he referred to the effect as having caused ''the flow of securities sales [to be] diverted from the most economically efficient channels and directed to New York,'' resulting in ''diversion of interstate commerce and diminution of free competition in securities sales . . . .''[78]

The opposite view, taken by the defendants in *Cuno*, is that a narrower reading of the Court's cases is possible—and desirable. Drawing on the arguments of two state and local tax practitioners,[79] DaimlerChrysler argued that only those taxes that ''penalize'' interstate commercial activity should fall under the DCCD.[80] Under this approach, a tax incentive that distinguishes ''between in-state and out-of-state activities'' and ''rewards in-state activities without similarly rewarding the same out-of-state activities'' would not violate the DCCD as long as it doesn't have a ''negative impact'' on protected commerce.[81] However, as Walter Hellerstein and Dan Coenen have astutely pointed out, the Court itself has rejected arguments that the DCCD should make a distinction between benefits to in-state

[75] A good deal of Professor Enrich's article makes the normative case against state investment incentives. See *id.* at 378–405.

[76] 429 U.S. 318, 332 (1977).

[77] *Id.* at 336 (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 145 (1970)).

[78] *Id.*

[79] Philip M. Tatarowicz & Rebecca F. Mims-Velarde, An Analytical Approach to State Tax Discrimination Under the Commerce Clause, 39 Vand. L. Rev. 879 (1986).

[80] Cuno v. DaimlerChrysler Corp., 386 F.3d 738, 745 (6th Cir. 2004).

[81] Tatarowicz & Mims-Velarde, *supra* note 79, at 928–29.

activity and burdens on out-of-state activity.[82] More i[illegible] in their opinion is the penalty analysis's failure "to draw a meaningful line between a tax incentive that penalizes out-of-state activity and one that merely rewards in-state activity."[83] Perhaps the reward/penalty distinction could be refined by resort to extrinsic aids, like evidence regarding the likely purpose of the statute—the purpose of both New York's securities transfer tax and Louisiana's first-use tax seemed aimed at penalizing specific out-of-state commerce, or at least protecting in-state industries, rather than rewarding in-state activity—though a purpose-based inquiry is not without its own difficulties.

Hellerstein and Coenen proposed yet another approach, one ultimately adopted by the lower court in *Cuno*. Conscious of the need to avoid giving free rein to some of the Court's more expansive language noted above, Hellerstein and Coenen proposed the following analytical framework for tax incentive decisions. "First, the provision must favor in-state over out-of-state activities; second, the provision must implicate the coercive power of the state. If, but only if, both of these conditions are met, courts should declare the tax incentive unconstitutional."[84] Specifically, tax incentives that provide relief to *existing* taxpayers within the state implicate the "coercive power of the state" in ways that Hellerstein and Coenen find constitutionally unacceptable.[85] If, however, the incentives involve "exemptions from or reductions of *additional* state tax liability to which the taxpayer would be subjected only if the taxpayer were to engage in the targeted activity in the state," the constitutional values of the DCCD are not implicated.[86] In addition, Hellerstein and Coenen would largely preserve the Court's disparate treatment of taxes and subsidies.[87]

[82] Walter Hellerstein & Dan T. Coenen, Commerce Clause Restraints on State Business Development Incentives, 81 Cornell L. Rev. 789, 814 (1996).

[83] *Id.*

[84] *Id.* at 806.

[85] *Id.* at 807.

[86] *Id.*

[87] *Id.* at 838–48; see also Dan T. Coenen, Business Subsidies and the Dormant Commerce Clause, 107 Yale L.J. 965 (1997). There is a fourth take on *Cuno*. Edward Zelinsky has written that *Cuno* represents the *reductio ad absurdum* of an anti-discrimination principle that distinguishes between economically identical activities, like taxes and subsidies. His solution is to junk the anti-discrimination principle, at least in tax cases, and to leave other doctrines and the political processes to police state abuses.

III. Rethinking "Discrimination" in the DCCD

Cuno has always struck me as a difficult case for two reasons. First, it was somewhat different than the ordinary facial discrimination case in which in-state economic actors were favored over competitors from out-of-state. The tax credit, for example, did not depend on the geographic origin of the firm seeking it, though it did make a geographical distinction regarding the economic activity at issue. Even so, the Ohio credit simply *felt* different than the tax incentives in the cases discussed above. The actions of Ohio in *Limbach*, New York in *Westinghouse* and *Boston Stock Exchange*, and Louisiana in enacting its first-use tax seemed to conform more readily to the paradigm of "protectionism," at which the DCCD's anti-discrimination principle is said to be primarily directed.

These difficulties lead to a series of deeper questions. What *is* discrimination? Why has it emerged as a central concern of the DCCD? Upon close reading, the Court has not been particularly helpful at answering either of these questions in its opinions. As to the first, labeling a law as "discriminatory" is really a conclusion rather than an explanation. The Court usually defines "discrimination" under the DCCD as differential treatment of in-state and out-of-state activity or economic actors that benefits the former and burdens the latter.[88] But this seems both over- and underinclusive, since the Court has consistently refused to consider the *amount* of burden to out-of-state actors[89] and because the Court doesn't require a showing of any actual benefit to particular in-state competitors.

As for the second question, the Court (along with many scholars) has tended to assume the Framers' interest was in creating and supporting a national common market, the better to facilitate free

See, e.g., Zelinsky, Restoring Politics to the Commerce Clause, *supra* note 6, at 29–32 (summarizing argument). A current work-in-progress responds to Professor Zelinsky's arguments. Brannon P. Denning, The Indispensibility of the Anti-Discrimination Principle to the Dormant Commerce Clause Doctrine: A Response to Edward Zelinsky (July 4, 2006) (copy on file with author).

[88]See, e.g., Granholm v. Heald, 544 U.S. 460, 472 (2005); Oregon Waste Systems, Inc. v. Dept. Environmental Quality, 511 U.S. 93, 99 (1994).

[89]See, e.g., Boston Stock Exchange v. State Tax Commission, 429 U.S. 318, 333 (1997) (rejecting a de minimis argument).

trade.[90] With free trade as the constitutional value the DCCD protects, it follows for anyone holding that view that the doctrine would evolve to eliminate as many state obstacles to free trade as possible. This view finds particular expression in Justice White's opinions in *Bacchus Imports* and *Boston Stock Exchange*. But as Professor Enrich's writings suggest, adopting a strong version of this view converts the DCCD into a form of economic substantive due process, empowering federal courts to invalidate portions of state and local regulatory schemes based on an amorphous conclusion that the effects ''distort'' the national economy.

My evolving view of the DCCD is that this focus is misplaced.[91] I have argued elsewhere that the Framers seemed anxious to centralize power over interstate commerce to prevent the cycles of disfavored treatment and retaliation among states not uncommon during the Confederation era.[92] Ensuring the elimination of interstate trade barriers was not driven by ideological attachment to free trade itself, but was rather a means to the end of interstate harmony and national political unity, both of which were threatened by the trade conflicts of the mid-1780s.

Thus, there is much to Thomas Reed Powell's quip that one writing the Restatement of Constitutional Law would include, as part of the black-letter text, the sentence: '''Congress may regulate interstate commerce.' A Comment would add: 'The states may also regulate interstate commerce, but not too much.' And then there would follow a Caveat: 'How much is too much is beyond the scope of this Restatement.'''[93] The Framers, I have concluded, thought that the Commerce Clause, along with other specific provisions, operated to restrain the

[90]This rationale is especially pronounced in the cases described above. See, e.g., *id.* at 334–35, 336–37 (discussing the ''free trade purpose'' of the Commerce Clause); see also Maryland v. Louisiana, 451 U.S. 725, 754 (1981).

[91]See, e.g., Denning, Indispensibility of the Anti-Discrimination Principle, *supra* note 87 (forthcoming). This position is not completely unique to me. See also Richard B. Collins, Economic Union as a Constitutional Value, 63 N.Y.U. L. Rev. 43 (1988); Maxwell L. Stearns, A Beautiful Mend: A Game Theoretical Analysis of the Dormant Commerce Clause Doctrine, 45 Wm. & Mary L. Rev. 1 (2003).

[92]See generally Brannon P. Denning, Confederation-Era Discrimination against Interstate Commerce and the Legitimacy of the Dormant Commerce Clause Doctrine, 94 Ky. L.J. 37 (2005–2006).

[93]Paul A. Freund, Foreword, in Thomas Reed Powell, Vagaries and Varieties in Constitutional Interpretation ix (1956) (Lawbook Exchange reprint 2002).

states, but the extent of that restraint was not thought [illegible].[94] The whole history of the DCCD has been a working out [illegible]s Caveat.[95] How much *is* too much?

All of the doctrinal tests that have emerged from the Court's DCCD jurisprudence—Chief Justice Marshall's distinction between police powers regulations and regulations of interstate commerce *qua* commerce; *Cooley*'s national/local distinction; the direct/indirect test; balancing; the anti-discrimination principle—have been attempts to implement[96] the constitutional principle that states can't regulate interstate commerce ''too much.'' The Court's entire DCCD project has been a temporally extended attempt to craft ''decision rules'' to implement the ''constitutional operative proposition'' the Constitution compels.[97]

The failure to clearly distinguish the implementing or decision rules from what, exactly, the Constitution requires has led to the confusion that plagues not only *Cuno*, but also discussion of the DCCD generally. Clarifying what Mitchell Berman calls the ''constitutional operative proposition'' and distinguishing it from the decision rules intended to implement the proposition—as well as defending those rules themselves—holds the possibility of clarifying the DCCD in ways that the efforts of scholars to work from the bottom up, synthesizing and reconciling conflicting DCCD decisions, has not.

As suggested above, I think that the Framers worried more about preservation of interstate harmony in the service of political union—sometimes expressed in the Court's opinions as the prevention of economic Balkanization—than about free trade itself. However, as Thomas Powell's restatement demonstrates, saying that ''States may not regulate interstate commerce in a way that endangers national political union'' will not decide concrete cases. Therefore, the Court has to create tools that will.

[94] Denning, Confederation-Era Discrimination, *supra* note 92, at 90.

[95] For a too-brief summary of that doctrinal history, see *id.* at 91 n.308.

[96] I use this term in the sense that Richard Fallon does—the creation of doctrinal tools to operationalize otherwise vague constitutional principles. See Richard H. Fallon, Jr., Implementing the Constitution (2001).

[97] See generally Mitchell Berman, Constitutional Decision Rules, 90 Va. L. Rev. 1 (2004); Kermit Roosevelt, III, Constitutional Calcification: How the Law Becomes What the Court Does, 91 Va. L. Rev. 1649 (2005).

The Court used to apply the DCCD through the creation of conceptual categories of state regulation—regulation of navigation and carriers, inspection laws, regulation of intrastate sales of goods, for example—each with its own set of rules.[98] Since the early 1970s, however, the Court has tended to approach DCCD questions through the two-tier standard of review, whose level of scrutiny turns on whether or not ''discrimination'' exists.

As a defining concept in the DCCD, one that very nearly determines the validity or invalidity of state regulations, discrimination has won out, I would argue, because it is the better proxy for the reasons states had their commercial regulatory powers limited in the first place. In many of the examples of Confederation-era commercial friction, states sought competitive advantages for their products or sought to benefit their citizens and wanted someone else, i.e., out-of-state commercial actors, to bear the cost. *Those* producers' or traders' states would then retaliate, sometimes setting off a cycle of protectionism and retaliation that inhibited amicable relations and frustrated efforts to forge any type of national identity.[99]

What emerged as the DCCD's anti-discrimination principle could be regarded as a prophylactic rule, willing to tolerate more false positives rather than risking false negatives in the service of national unity. Thus, as states got the message that facially discriminatory laws would not survive judicial scrutiny, and passed facially-neutral statutes that burdened out-of-state commerce the same as facially-discriminatory laws did, the Court adapted the doctrine in response.[100]

But in the press of refining the doctrinal tests for discrimination, the purpose the anti-discrimination principle served was lost. The result is what Kim Roosevelt terms ''constitutional calcification.''[101]

[98]See Michael S. Greve, The Dormant Commerce Clause as an Ex Ante Rule 10 (''The history of the dormant Commerce Clause over the past seven decades can be understood as a sustained effort to move from subject-matter limitation to procedure (for lack of a better word), from exclusivity to antidiscrimination.'') (unpublished manuscript on file with author).

[99]For examples, see Denning, Confederation-Era Discrimination, *supra* note 92, at 40–48, 59–66, 70–73.

[100]See, e.g., Hunt v. Washington Apple Advertisers Commission, 432 U.S. 333 (1977); Dean Milk v. Madison, 340 U.S. 349 (1951); H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525 (1949).

[101]Roosevelt, *supra* note 97, at 1692–93.

Three major problems result from calcification, accordin[illegible]velt: (1) ''doctrinal deformation'' in which good decisio[illegible]e mistakenly discarded or are accepted as the operative propositions, while other doctrinal changes are made to maintain consistency;[102] (2) treatment of decision rules as operative propositions whereby the Court ''announces as constitutional truths rules that should neither be followed by nonjudicial actors nor internalized by the general public'';[103] and (3) inflation of the judicial role, as calcification calls into question the notion the Court is but one of many bodies with responsibility for constitutional interpretation.[104]

The current DCCD shares at least some of each of these aspects of calcification. First, while overstated, it is widely perceived (even by members of the Court) that the doctrine is inconsistent, if not incoherent.[105] This means, of course, we only know what the DCCD will or will not permit when the Court tells us. Moreover, as I have been emphasizing in this section, there has been a growing tendency to focus on the elimination of discrimination either as an end in and of itself, or in the service of an assumed free-trade orientation of the Constitution. This both conflates the rules and operative proposition, and has resulted in the deformation of the DCCD itself. Expansion of the doctrine to invalidate ''economically distorting'' or ''inefficient'' state laws would merely push the DCCD further afield.[106]

* * *

What then is to be done? In my view, the anti-discrimination principle needs to be re-tethered to the constitutional operative proposition it was supposed to implement. While a complete reconceptu-

[102] *Id.* at 1693.

[103] *Id.* at 1713.

[104] *Id.* at 1716–17.

[105] See, e.g., Camps Newfound/Owatonna v. Harrison, 520 U.S. 564, 611 & n.3 (1997) (Thomas, J., dissenting). For three ready examples of cases with similar facts but different outcomes, compare West Lynn Creamery v. Healy, 513 U.S. 168 (1994), with Pharmaceutical Research and Manufacturers Association v. Walsh, 538 U.S. 644 (2003); and Hunt v. Washington Apple Advertisers Association, 432 U.S. 333 (1977), with Exxon v. Maryland, 437 U.S. 117 (1978); and Maine v. Taylor, 477 U.S. 131 (1986), with Hughes v. Oklahoma, 441 U.S. 322 (1979).

[106] Cf. Michael J. Graetz & Alvin C. Warren, Jr., Income Tax Discrimination and the Political and Economic Integration of Europe, 115 Yale L.J. 1186 (2006) (arguing that the decisions of the European Court of Justice regarding taxation suffer from a similar drift).

alization of the principle must await another article.[107] I offer the following as a first cut at the direction such a rethinking might take. First, political union and preventing of interstate friction must replace ''free trade'' as the constitutional value that lies at the heart of the DCCD. Second, the anti-discrimination principle itself must be recognized as a mere tool used to refine and implement that value, not as an end itself.

Therefore, I propose that courts ask the following questions when deciding whether a law is ''discriminatory,'' and thus presumed unconstitutional under the DCCD. First, does the law favor in-state over out-of-state economic interests, either by benefiting the former or burdening or penalizing the latter? Second, is the means by which the in-state interest is benefited or the out-of-state interest penalized likely to produce retaliatory action on the part of other states or local governments? Only if the answer to both questions is ''yes,'' would a reviewing court apply strict scrutiny, which would still give the state or local government the opportunity to prove that the end was legitimate and that there was no less discriminatory means to achieve that end.

The obvious question is whether it is possible for courts to perform Step Two of my analysis with any degree of certainty.[108] I think that it is possible, and that judges might approach this second step in a variety of ways. First, as the Court does now, judges might create presumptions that certain categories of laws, if they favor in-staters or burden out-of-staters, are likely to encourage replication or retaliation. Tariffs and embargoes are the historic paradigms here.

Second, for laws that do not neatly fit within these categories, courts might rely on other states themselves to sound ''fire alarms'' over state and local laws, alerting the Court to state abuses. In a fascinating recent article, Professor Chris Drahozal found that since 1970 ''the Court has struck down state statutes more often when a state or local government challenged the statute, either as a party or as an amicus curiae, than when no government entity challenged

[107] I offer some more details in Denning, Indispensibility of the Anti-Discrimination Principle, *supra* note 87.

[108] See generally Adrian Vermeule, Judging Under Uncertainty (2006) (arguing that few interpretive theories pay sufficient attention to the institutional capacities of courts and the judges that staff them).

the statute.''[109] The two cases in which the Court upheld [illegible]s despite opposition by other state governments, Draho[illegible], confirm ''the wisdom of heeding fire alarms,'' since the cases ''have been soundly criticized . . . .''[110]

A third possibility is for the Court to perform a sort of thought experiment, asking what would happen if all or most states adopted a particular tax or regulation. Would widespread adoption tend to undermine or inhibit political union, including the economic ties that bind states to one another? Such an inquiry would be similar to the ''internal consistency'' test the Court uses as part of its DCCD analysis in tax cases. For a tax to be internally consistent, the Court asks whether a similar tax, imposed by all states, would place interstate commerce at a disadvantage relative to intrastate commerce.[111] If it would, then the tax is unconstitutional.

This is, of course, meant to be neither a comprehensive list, nor an in-depth discussion of the possibilities I did mention. Such a discussion will require a separate article, which I hope to write. I merely intended to show that there is no reason to assume that attempts to tie the concept of discrimination more closely to the specific evils the Framers likely had in mind when they decided to limit state power over interstate commerce will tax judicial competence.

And what about the tax incentive offered in *Cuno*? Here we come full-circle. If one applies the two-step test I articulate above, I think that the Ohio tax incentive would pass muster. While the law certainly favored in-state activity over that occurring outside the state, it was not restricted to *Ohio* corporations agreeing to locate in Ohio. Nevertheless, let's assume that it would fail the first part of the test. The tax incentive does not seem like the kind of measure that would inaugurate a cycle of retaliation among states that would undermine political or economic unity. Subsidies (''bounties'') were not

[109] Christopher R. Drahozal, Preserving the American Common Market: State and Local Governments in the United States Supreme Court, 7 S. Ct. Econ. Rev. 233, 253 (1999).

[110] *Id.* at 270.

[111] See Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995); see generally 1 Jerome Hellerstein & Walter Hellerstein, State Taxation ¶ 4.15[1][a] at 4-132 (3d ed. 1993 & 2006 Supp.).

unknown at the time of the Framing—states often sought to stimulate the production of goods with cash payments—none seemed to complain about them. Presumably if they worked, other states would emulate them, perhaps offering larger bounties to compete for producers to locate in their state.

This appears to be precisely what states, in fact, do with business tax incentives. While some might term this a "race to the bottom," because the tax revenues foregone in the quest for business tend to be made up out of spending for public goods like education, the harm, to the extent it exists, is visited on state citizens themselves. It may be bad public policy for states to engage in this kind of competition for business, but that does not make it unconstitutional. Nor do I think that kind of competition *is* unconstitutional, given the unlikelihood that it will bring states and local governments into conflict with one another.

Conclusion

To one hoping for a definitive resolution of the constitutional questions surrounding subsidies and tax incentives, *Cuno* was bound to have been a disappointment. By deciding the case on standing grounds, the Court clearly signaled a desire to leave the merits for another day. And, as I expressed elsewhere,[112] there are reasons to celebrate the Court's minimalist resolution of the case. I argued in the second half of this essay that *Cuno*'s difficulty lies in the imprecision infecting the Court's use of the term "discrimination." This is unfortunate, since concluding that a state or local law is discriminatory vis-à-vis interstate commerce virtually decides whether the law stands or falls under the DCCD. Those of us interested in the DCCD should take the lull provided by *Cuno* to examine the concept more closely in light of the reasons the DCCD evolved in the first place. If, as I have argued, the DCCD was intended to prevent political disharmony caused by economic competition during the Confederation era, then the rules the Court has developed, which proceed on the assumption that an ideological affinity for free trade drove the Framers, should be rethought. Even if the specific reworkings of the antidiscrimination principle I have lightly sketched here are unconvincing, I do hope that they spark a conversation that informs future academic discussion and judicial application of the DCCD.

[112]See Denning, Cuno and the Court, *supra* note 4.