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A Beautiful Mend:
A Game Theoretical Analysis of the
Dormant Commerce Clause Doctrine

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A Beautiful Mend:
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Maxwell L. Stearns*

Abstract

While the commerce clause neither mentions federal courts nor expressly prohibits the exercise of state regulatory powers that might operate concurrently with Congressional commerce powers, the Supreme Court has long used the dormant commerce clause doctrine to limit the power of states to regulate across a diverse array of subject areas in the absence of federal legislation. Commentators have criticized the Court less for creating the doctrine than for applying it in a seemingly inconsistent, or even haphazard, way. Past commentators have recognized that a game theoretical model, the prisoners' dilemma, can be used to explain the role of the dormant commerce clause doctrine in promoting cooperation among states by inhibiting a regime of mutual defection. This model, however, provides at best a partial account of existing dormant commerce clause doctrine, and sometimes seems to run directly counter to actual case results. The difficulty is not the power of game theory to provide a positive account of the cases or to provide the dormant commerce clause doctrine with a meaningful normative foundation. Rather, the problem has been the limited choice of models drawn from game theory to explain the conditions in which states rationally elect to avoid mutually beneficial cooperative strategies with other states. Professor Stearns shows how a state might avoid cooperation in a situation not captured in the prisoners' dilemma account to disrupt a multiple Nash equilibrium game, thus producing an undesirable mixed strategy equilibrium in place of two or more available pro-commerce, Nash equilibrium outcomes. At the same time, the defecting state secures a rent that only became available as a consequence of the Nash equilibrium, pro-commerce strategies of surrounding states and that is closely analogous to quasi rents described in the literature on relational contracting. The combined game theoretical analysis, drawing upon the prisoners' dilemma and multiple Nash equilibrium games, not only explains several of the most criticized features of the dormant commerce clause and several related doctrines, but also underscores the proper normative relationship between the dormant commerce clause doctrine and various forms of state law rent seeking.

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I do not think the United States would come to an end if we lost our power to declare an Act of Congress void. I do think the Union would be imperiled if we could not make that declaration as to the laws of the several States. For one in my place sees how often a local policy prevails with those who are not trained to national views and how often action is taken that embodies what the Commerce Clause was meant to end.[????]

[I]n the 114 years since the doctrine of the negative commerce clause was formally adopted as holding of this Court . . . and in the 50 years prior to that in which it was alluded to in various dicta of the Court . . . our applications of the doctrine have, not to put too fine a point on the matter, made no sense.[??????]

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[2] O.W. HOLMES, COLLECTED LEGAL PAPERS 295-96 (1920).

[3] Tyler Pipe Industries, Inc. v. Wash. State Dept. Rev., 483 U.S. 232, 260 (1987) (Scalia, J., concurring in part and dissenting in part).

I. Introduction

Describing the pivotal scene in *A Beautiful Mind*,[4] the 2002 Academy Award winner for best picture, is perhaps more problematic for its mathematical, than for its political, incorrectness. The disturbed but brilliant John Nash, a mathematics graduate student at Princeton, is in a bar with four classmates, all men. The men spot a group of women that includes an extremely attractive blonde. One of Nash's classmates offers the following assessment: According to the teachings of Adam Smith, if all members of the group pursue the blonde, competition, or the invisible hand, will increase the likelihood that each man will achieve his desired goal of "scoring" with one of the women.[5] In a burst of mathematical, if not hormonal, inspiration (Nash leaves the bar without pursuing any of the women),[6] Nash suddenly realizes that this two century old conventional economic wisdom–suggesting that competition produces the socially optimal result–is in this context misplaced. Nash then articulates what the movie presents as his core insight, justifying his receipt, some fifty years later, of the 1994 Nobel Prize in Economics.

Nash counters his classmate by explaining that unlimited competition would prevent the five men from achieving their desired objectives. If all five men pursue the blonde, in their simultaneous pursuit they will block each other from succeeding with her. And by pursuing that strategy, the men will offend the remaining women, none of whom would respond favorably to being considered a consolation prize. In this context, Nash suggests, competition threatens to produce an inferior result to that which could be achieved if the men instead coordinated their pursuits. According to Nash, if the men eschewed the blonde in favor of a coordinated effort in which each pursued one of the remaining women, each man's prospect for success would significantly increase.

The purpose here, of course, is not to analyze boorish male behavior. Nor is it to defend the accuracy to this particular historical account, one that, at least for this viewer, seems implausible even for an earlier generation of Princeton mathematics graduate students.[7] Rather,

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[4] *A Beautiful Mind* (Universal Studios 2001).

[5] For the original, and admittedly less intriguing, illustrations of the invisible hand proposition, see ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (Edward Cannan, ed. 1976).

[6] This is not an appropriate forum in which to evaluate the decision of director Ron Howard, to avoid including any express references to Nash's apparent sexual interest in men, *compare* Matthew Gilbert, *'American Experience' revisits Nash saga in 'Brilliant Madness,'*, N29 Chicago Tribune (April 27, 2002) (describing the movie's "deleting controversial information about the hero's possible homosexuality and anti-Semitism" as a "glaring example of how Hollywood whitewashes reality."); *with* Andrew Sullivan, *Running for an Oscar? Now that's serious politics*, *Times Newspapers Limited Sunday Times (London)* (March 10, 2002) (explaining that Ron Howard responded to allegations that his failure to depict Nash's homosexual past represented anti-gay editing by claiming that "he removed this aspect of Nash's life so people would not associate homosexuality with mental illness."). For a discussion of Nash's sexual interest in men, see SYLVIA NASAR, A BEAUTIFUL MIND 43 (1998). Although the theme is not developed in the remainder of the film, it is possible to view Nash's departure from the bar scene as a reference, however oblique, to his sexuality.

[7] It is noteworthy that this scene is not recounted in Sylvia Nasser's book, which provided the basis for the

my objective is to compare the game theoretical insight presented in this now famous bar scene with the actual insight that gave rise to John Nash's eventual receipt of the Nobel prize.

The bar scene reveals a coordination difficulty that the men appeared to confront in their efforts to secure their individual objectives. Absent coordination, given their first choice strategies, the prospect for success by each individual actor was substantially lower than with coordination.[8] The problem of coordinated strategies is not uncommon to game theory; indeed it lies at the base of what is likely the most well known game, the prisoners' dilemma.

In the standard prisoners' dilemma game, the inability of two prisoners to coordinate their behavior or to enforce any prior agreements yields an outcome for each that is inferior to that which would have been available had the prisoners followed a strategy of mutual cooperation. In this familiar game, each prisoner is informed that she will receive a modest sentence if both rat out the other; that she will be let free if she alone rats out the other, while the other will get a maximum sentence; and that both will receive a significant sentence short of the maximum if both rat out each other. Behaving rationally, each prisoner has an incentive to defect because regardless of what the other player does, she can reduce her sentence by being an informant.[9] The problem that the prisoners' dilemma reveals is that with the given payments,[10] the players cannot achieve the potential superior outcome in which both remain silent and thus both receive minimal sentences because they are unable to coordinate their behavior.

The bar scene itself does not necessarily depict a prisoners' dilemma. Without any coordinated effort, any one (or more) of the mathematics graduate students could increase his prospect of succeeding with a woman other than the blonde by pursuing that strategy individually. His payoff from following that strategy is therefore independent of whether the other men pursue the same strategy.[11] For our immediate purpose, however, it is sufficient to note that participants in cooperation/defection games of this sort confront incentives that threaten to produce payoffs that are inferior to those that are otherwise available if the participants are unmotivated (as might have been the case in the Princeton bar) or unable (as in the prisoners' dilemma), to coordinate their behavior.

At least one prominent game theorist has observed that the bar scene in *A Beautiful Mind* fails accurately to capture the true mathematical insight that resulted in Nash's receipt of the Nobel Prize.[12] Nash's foundational insight was not in recognizing that individuals can improve

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movie of the same name. *See* NASAR, *supra* note 3.

[8]As explained below, not only does this fail to capture Nash's true insight, but also, it might not accurately characterize the incentives in the bar scene game. *See infra* at 5.

[9]For a more formal presentation of the prisoners' dilemma game, see *infra* at III.B.1.

[10]It is, of course, the relationship between the payments, rather than the nominal payments, that produces the prisoners' dilemma.

[11]This assumes that if two or more men elect to pursue women other than the blonde, they will not pursue the same woman. If they did pursue the same woman, then they would confront anew the same coordination difficulty with regard to her that confronted them in their efforts to pursue the blonde.

[12]*See How Bad Things Can Happen,* NEWSWEEK INT'L (March 24, 2002) (presenting critical interview with

their positions by adopting cooperative strategies. Rather, it was in finding a solution that works in every possible game precisely because it does not require any coordination between or among the players. To illustrate, it will be helpful to introduce another familiar, but contrasting, game, this time involving driving.

In the driving game, two drivers are trying to devise a rule or custom that optimizes their payoffs, and in doing so, recognize the need to anticipate or otherwise account for the other driver's behavior. If we assume that the drivers are generally indifferent to left or right driving, but are concerned about personal safety, then the second driver will optimize her payoffs by mimicking the first driver's behavior, whether the initial regime is left or right. Unlike the prisoners' dilemma game, in which the payoffs produce a single dominant outcome–mutual defection–in the driving game, the payoffs produce two possible stable outcomes–(right, right) or (left, left). The alternative mixed strategies–(right, left) or (left, right)–produce payoffs that can be improved if either of the two drivers changes to the other's chosen regime.[13] And most importantly, the higher payoffs are achieved without the players formally coordinating their behavior. Nash's core insight was that there is a unique solution (as in the prisoners' dilemma) or a set of available solutions (as in the driving game) that are stable equilibria because they produce the maximum payoffs for each player given the likely strategies of the other players in the absence of any coordination with the other players.

This brief introduction to cooperative and non-cooperative games provides an apt prelude to the dormant commerce clause doctrine and to the game theoretical analysis of that doctrine offered in this article. The dormant commerce clause doctrine has long been the subject to two lines of judicial and academic criticism. First, while Article I, § 8, grants Congress the power "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes,"[14] it says nothing of the power of federal courts to strike down state laws found to undermine some conception of political or economic union when Congress is silent.[15] Indeed, the commerce clause neither mentions federal courts nor expressly prohibits the exercise of state

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Stanford game theorist, Paul Milgrom).

[13]This is not to suggest that whenever players confront a multiple Nash equilibrium game, the result of their uncoordinated efforts is invariably Nash. A non-Nash mixed strategy equilibrium can arise if the parties incorrectly guess at each others behavior, and lack an opportunity to correct their chosen regime after the fact. For a more detailed discussion and an explanation of why this problem is unlikely in the dormant commerce clause doctrine context, see *infra* note 222, and cite therein.

[14]U.S. CONST. Art. I, § 8, cl.3.

[15]Scholars are divided on whether the commerce clause is intended to facilitate political union, and thus to prevent intentional discrimination that might foment retaliatory measures by disadvantaged states, LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 417 (2d ed. 1988) (asserting that "the negative implications of the commerce clause derive principally from a *political* theory of union, not from an *economic* theory of free trade. The function of the clause is to ensure national solidarity, not economic efficiency."), or economic union and the notion of specialization and exchange (also referred to as comparative advantage), *see, e.g.,* Brannon P. Denning & Glen Harlan Reynolds, *Comfortably Penumbral*, 77 B.U. L. REV. 1089, 1101 (1997) (positing that "the Court has linked much of its dormant Commerce Clause jurisprudence to its assertion that one of the animating principles of the Constitution is economic union, which would be frustrated if states could enact discriminatory or protectionist legislation aimed at out-of-state commerce."). In this article, I argue that the dormant commerce clause doctrine furthers political, rather than economic, union.

regulatory powers that might operate concurrently with federal commerce clause powers. Second, critics have questioned the doctrine's effectiveness. One need not be a law and economics enthusiast to appreciate the inherent normative appeal of an open national market,[16] one that is unhindered by costly and obstructive state-imposed barriers to trade.[17] But assuming that to be the goal, then a doctrine that is pervasively viewed as "incoherent"[18] and "hopelessly confused"[19] seems unlikely to achieve it.

Despite these general criticisms of the doctrine, in the name of the dormant commerce clause, the Court has significantly limited the power of states to regulate across a wide range of subject areas, including train[20] and truck[21] safety; imports[22] and exports[23] of myriad goods and services; the conditions for the intake[24] and outflow[25] of solid and liquid waste; and insurance[26]

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[16]Economists characterize this in terms of promoting "comparative advantage." The critical insight is that one can have an absolute advantage in two endeavors and still benefit from specializing in one, and trading with another who although less skilled in the other in absolute terms, possesses a comparative advantage in it. Comparative advantage is, of course, the flip side of the economic concept of "opportunity cost." If I am an outstanding rock musician and typist, the opportunity cost of typing is simply too high for me to forego being a rock musician. Even if I have to hire someone who is slower at typing and who makes more mistakes, the typist and I will both be better off if we each pursue our respective comparative advantages.

[17]Indeed, Justice Thomas, who ranks among the conservative detractors on the present Court with respect to the dormant commerce clause doctrine has conceded its normative merit, observing that despite its absence of a textual basis, the rulings are both "intuitively desirable" and "constitutionally correct." *See* Camps Newfound/Owatanna, Inc. v. Harris, 117 S.Ct. 1590, 1616 (1997) (Thomas, J., dissenting). And of course the normative merit of an analysis like that associated with the dormant commerce clause is by no means limited to interstate trade. For a recent article that offers a Madisonian vision of GATT, see John O. McGinnis and Mark L. Movsesian, *The World Trade Constitution*, 114 HARV. L. REV. 511 (2000).

[18]See, e.g., Brian C. Newberry, Taking the Dormant Commerce Clause Too Far? - West Lynn Creamery, Inc. v. Healy, 114 S. Ct. 2205 (1994) ("Whether the issue is state taxation, state environmental regulation, truck safety, or something else, the cases have continually been decided on an ad hoc basis with the result being that there is no coherent theory for the Court to follow."); Winkfield F. Twyman, *Beyond Purpose: Addressing State Discrimination in Interstate Commerce*, 46 S.C.L. Rev. 383, 383 (1995) (describing dormant commerce clause doctrine as incoherent).

[19]*See* Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 706 (1981) (Rehnquist, J., dissenting).

[20]*See, e.g.,* Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945) (striking down state statute that limited train lengths to fourteen passenger or seventy freight cars).

[21]*See, e.g.,* Kassel v. Consolidated Freightways Corp., 450 U.S. 662 (1981) (plurality) (striking down Iowa statute that prohibited, with exceptions, the use of 65 foot twin trailers); Bibb v. Navajo Freight Lines, 359 U.S. 520 (1959) (striking down Illinois statute requiring the use of curved mudflaps when surrounding states required or permitted straight mudflaps).

[22]*See, e.g.,* Maine v. Taylor, 477 U.S. 131 (1986) (sustaining Maine statute that prohibited the import of live baitfish nonnative to Maine against dormant commerce clause challenge).

[23]*See, e.g.,* Sporhase v. Nebraska, 458 U.S. 941 (1982) (sustaining export restrictions on groundwater from Nebraska linked to conservation, but striking provisions that allowed exports to states that granted reciprocal rights to import groundwater).

[24]*See, e.g.,* City of Philadelphia v. New Jersey, 437 U.S. 617 (1978) (striking down New Jersey statute prohibiting the import of solid and liquid waste originating or collected out of state).

[25]*See, e.g.,* C & A Carbone, Inc. v. Clarkstown, 511 U.S. 383 (1994) (striking down municipal "flow control ordinance" that required waste generated in municipality to be processed in subsidized private waste transfer station).

[26]*See, e.g.,* United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944) (holding that insurance contracts are within interstate commerce); Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869 (1985)

and corporate law.[27] In virtually every case, the defending state has claimed that the challenged law is a valid exercise of traditional police powers, and is thus protected by the 10th amendment. The Court's seeming inconsistency in evaluating this defense has confounded both jurists and legal scholars.

This article's thesis is that viewed through the lens of game theory, the dormant commerce clause proves neither "incoherent" nor "hopefully confused." Quite the contrary, the dormant commerce clause doctrine, properly understood, furthers a vital set of objectives associated with political–as distinguished from economic–union between and among the states. This article will reveal that the dormant commerce clause cases can be cast along two analytical dimensions, each sharing a common end point. While the dormant commerce clause does not target ordinary in-state wealth transfers from diffuse to organized groups, it does target two specific types of rent seeking laws that have the significant potential, if sustained, to compromise the political relationships between and among states.

The first dimension of commerce clause cases involves state laws–most prominently tariffs and subsidies–that because they are obviously economically motivated would, if sustained, encourage adversely affected out-of-state interests to attempt to secure reciprocal protections in their own states. In the absence of benign dormant commerce clause intervention, the end result of this state-based prisoners' dilemma game would be one of mutual defection. And this is so even though it can be demonstrated that all states would be better off in the absence of such obvious protectionist measures. Indeed, as the Oliver Wendell Holmes quote makes plain,[28] this familiar account is often presented as the paradigmatic justification of the dormant commerce clause doctrine. This article will show that while significant to the overall objectives of the dormant commerce clause doctrine, this category represents but a slice of the most significant modern cases.

The second dimension involves laws through which individual states undermine other states in their efforts to adopt common pro-commerce strategies that represents one of two or more stable Nash equilibrium outcomes. While the rents pursued in these cases are not always apparent, for our immediate purposes it is sufficient to observe that a phenomenon much like efforts to secure appropriable quasi rents in relational contracting,[29] can arise when the relationship between two or more states creates an opportunity for another state to undermine the resulting gains from the common regime simply by adopting a contrary law. When this occurs, the motivation is not to secure the benefits flowing from the particular contrary regime–had the other states started with the contrary regime, the state whose law is challenged would still have an incentive to defect–but rather to appropriate the gains that other states have made available through the adoption of a common pro-commerce strategy. Thus, when several states permit

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(sustaining Alabama's differential tax scheme on insurance against dormant commerce clause challenge in light of McCarren-Ferguson Act, then striking it down based upon equal protection).

[27] *See* Edgar v. MITE Corp., 457 U.S. 624 (1982) (striking down Illinois antitakeover statute which allowed secretary of state to block tender upon finding failure to provide full and fair disclosure of material information, inequity, or fraud or deceit if 10% or more of the shareholders are located in Illinois); CTS v. Dynamics Corp., 481 U.S. 69 (1987) (sustaining Indiana statute that permitted control shares in Indiana corporation to be voted only if other shareholders passed approving resolution).

[28] *See supra* note **, and accompanying text.

[29] *See infra* notes 198, 199, 224, and 225, and accompanying text.

combined trucks of a particular length, a certain type of mudflap, or trains that meet particular specifications, a state that seeks to minimize its own contribution to facilitating a regime of interstate commerce can upset the resulting gains simply by adopting a contrary regime, even if the contrary regime has no more to commend it than that adopted more generally by other states. In these cases, when the Supreme Court strikes down the challenged law on grounds that it "burdens" commerce, in effect the Court restores a benign multiple Nash equilibrium game in which it effectively ratifies the choice of the early movants followed by other states. It does so not because the chosen regime is superior to the alternative, but rather because the commonality of the regime is more important than the particular choice of regime. In effect the Court tells the state whose law is under review that while the states are free to choose any of two or more available Nash equilibrium outcomes, individual states are not free, after a common regime is in place, to prevent other states from their choice of a Nash outcome, at least absent a sufficient demonstration that the motivation is other than to disrupt a Nash strategy.

Perhaps the most significant insight of this article is that while the Supreme Court has employed the dormant commerce clause to target those narrow forms of rent seeking through which individual states encourage other states to adopt comparable anti-commerce, protectionist measures or through which individual states undermine other states' common pro-commerce strategies, the dormant commerce clause doctrine is not targeted against rent seeking as such. The common end point for each of these two prohibited dimensions of rent seeking under the dormant commerce clause doctrine involves the successful efforts of organized in-state interests to secure rents at the expense of diffuse constituents, when the resulting laws, although costly and inefficient, are not likely to motivate other states to confer reciprocal protections, and when the result does not undermine the common pro-commerce strategies of other states. Simply put, the dormant commerce clause is not a subterfuge for economic substantive due process. Rather, it is motivated to further interstate commerce. As a result, the Supreme Court has employed the doctrine to target those state rent seeking laws that, if sustained, would compromise commerce respecting *other states* either by encouraging them to enact comparably undesirable laws or by undermining a desirable common pro-commerce regime that is already in place.

Jurists and legal scholars have long condemned the dormant commerce clause doctrine because of its dubious textual basis and because of the apparent haphazard manner through which it is applied.[30] In this article, I will show that the latter claim does not bear careful scrutiny. A game theoretical analysis of the dormant commerce clause doctrine will show that while the Court could improve its application of the doctrine in discrete areas, the doctrine has been applied in a manner that is generally coherent and that furthers credible and important objectives associated with interstate commerce. As for the claim of textual illegitimacy, the answer rests on one's willingness to afford the Court power when the Constitution itself is either ambiguous or broadly worded. The primary mission of this article is to offer a positive account of the dormant commerce clause doctrine, one that explains even the most controversial cases. But in so doing, it offers a sound normative basis for this extremely important doctrine. In short, while it might have been preferable had the framers expressly afforded the Court dormant commerce clause power, in the absence of such an expression, this article will explain why the dormant commerce clause doctrine as currently applied represents A Beautiful Mend that helps

[30]*See supra* notes 15 and 16, and cites therein.

to further the Constitution's overriding commitment to a strong political union between and among states.

While the game theoretical model of the dormant commerce clause will not eliminate all of the doctrinal anomalies, the anomalies that it does explain are of central importance to existing debates over the doctrine's proper scope, its normative underpinnings, and its doctrinal coherence. And most notably, the model provides a foundation for the exceptions to the dormant commerce clause doctrine as well as the dormant commerce clause doctrine itself. In addition to explaining the two dominant dimensions of dormant commerce clause jurisprudence described above, I will provide a positive explanation of such related doctrines as state as market participant, a much contested exception to dormant commerce clause scrutiny[31]; Article IV privileges and immunities, a clause that has been used as a limited de facto exception to the market participant doctrine with the effect of restoring the functional equivalent of dormant commerce clause scrutiny[32]; and export taxation, a doctrine that appears to allow states to impose significant burdens on commerce with minimal judicial scrutiny.[33] While it is commonplace in the dormant commerce clause literature to cordon off these separate doctrines, and to limit the analysis that has been offered only to the dormant commerce clause cases,[34] or to a subset of those cases,[35] this article deliberately takes the opposite approach. Rather than dismissing these doctrines summarily at the end, the rational choice model takes them head-on. After all, the analysis that I offer cannot be described as robust if it loses its explanatory force simply because the Court has invoked an alternative doctrinal label in characterizing the operative case facts. In fact, the game theoretical model is strengthened when the scope of inquiry is broadened to include these doctrinal exceptions.

The article proceeds as follows. In part II, I will sketch the existing dormant commerce clause doctrine, and the related doctrines involving market participation, export taxation, and Article IV privileges and immunities. This part will expose several of the most significant anomalies that have proven problematic for traditional doctrinal analysis, even when that analysis is primarily motivated by a desire to reconcile existing doctrine.[36] Part III, which will also draw upon tools from price theory, public choice, and the study of transactions costs, will set out the game theoretical model of the dormant commerce clause. Part IV will apply the game theoretical model developed in part III to the cases and doctrines described in part II, and offer some modest suggestions for improving existing doctrine. Part V will conclude the article.

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[31]*See infra* parts II.C.3 and IV.A.

[32]*See infra* parts II.C.4 and IV.A. The doctrine is limited because it does not apply to corporations and because it only applies to fundamental rights. *See* Paul v. Virginia, 75 U.S. (8 Wall.) 168 (1868).

[33]*See infra* parts II.C.5 and IV.A.

[34]*See, e.g.,* Michael A. Lawrence, *Toward a More Coherent Dormant Commerce Clause: A Proposed Unitary Framework*, 21 HARV. J.L. & PUB. POL'Y 395, 462 (1998) (noting that his proposed "Unitary Framework [offered to explain the dormant commerce clause doctrine] does not apply . . . to two sorts of state regulations impacting interstate commerce: (1) state regulations involving taxation; and (2) state regulations where the State is a 'market participant.'").

[35]*See, e.g.,* Donald Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091 (1986) (focusing on the movement-of-goods cases).

[36]For an informative article along these lines, see Lawrence, *supra* note 31. For an article that seeks to reconcile the movement-of-goods cases, see *See* Regan, *supra* note 32.

II. The Dormant Commerce Clause Doctrine: Anomalies and Inconsistencies

As suggested in Justice Scalia's opening quote,[37] the dormant commerce clause has among the longest histories of any active constitutional law doctrine, and especially of any body of law that is widely viewed as an illegitimate judicial innovation. Although some context will be helpful, it is not necessary to provide a comprehensive historical account of the dormant commerce clause for the game theoretical analysis to follow. Instead, this part will sketch the contours of the commerce clause and related doctrines as they presently exist. In setting out the relevant cases and doctrines, I will remain true to the Court's own articulation of the governing tests and standards. I will deliberately seek to avoid presenting characterizations that could be viewed as tendentious or as an effort to cleverly fit the cases into a neat doctrinal or theoretical framework. Instead, my objective is to describe the doctrine in the Court's own terms, and in doing so, to expose the various inconsistencies that have long been the focus of judicial and academic commentary.

In this part, I will follow a conventional presentation, one that places the doctrine's exceptions at the end, as apparent inconsistencies to be explained. In part IV, I will use the model developed in part III to show that reversing much of the conventional presentation will allow us to synthesize the game theoretical analysis with existing case law and to show that the dormant commerce clause and associated doctrines can be defended on credible normative grounds.

The dormant commerce clause cases are divided in numerous ways in the literature, and I do not intend to suggest that my method of presentation is the only one that is correct.[38] The purpose of this presentation is to identify the principal case categories, and then to reveal within each of those categories the principal doctrinal anomalies that have been identified in the literature to criticize the dormant commerce clause and its related doctrines.[39] The purpose of the division and classification, in any event, is not to reconcile the existing cases or doctrines. That comes later. Instead, it is to highlight the conflicts that have motivated much academic and judicial commentary in a manner that remains true to the doctrines as the Court itself has expressed them. Because some of the anomalies relate to foundational aspects of the dormant commerce clause doctrine, including its default status and the doctrine's relationship to the Court's affirmative commerce clause jurisprudence, the next two subparts will provide a background on the early history of the dormant commerce clause doctrine and an overview of the modern commerce clause cases.[40] The part that follows provides the framework for evaluating the modern dormant commerce clause cases, which are the principal focus of this article.

A. The Dormant Commerce Clause in the Marshall, Taney, and Fuller Courts

An analysis of the dormant commerce clause necessarily begins with *Gibbons v. Ogden.*[41] The dispute between Chief Justice Marshall and Justice Johnson in the landmark commerce clause case centered on the basis for striking down the challenged New York license granted to

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

[38] For other informative approaches, see, e.g., *supra* notes 31 and 32, and cites therein.

[39] The four principal categories are summarized in Table 3, *infra* at 40, and the anomalies that are associated with each category are set out in Table 4, *infra* at 47.

[40] Readers familiar with these aspects of the Court's commerce clause jurisprudence are invited to skip ahead to part II.C.

[41] 22 U.S. (Wheat.) 1 (1824).

Fulton and Livingston, who in turn granted it to Ogden, where Gibbons claimed a competing right to operate a "vessel[] [in] the coasting trade" in the same waters pursuant to a federal statute enacted in 1793. Chief Justice Marshall spent most of his famous opinion answering the question whether commerce comprehends navigation, and if so, whether Congress has the power to regulate navigation that occurs within the boundaries of a single state against that state's contrary regulation. Marshall's affirmative answer to both questions rested upon his understanding that "Commerce, undoubtedly, is traffic, but it is something more. It is intercourse."[42] Marshall observed that the "power over commerce, including navigation, was one of the primary objects for which the people of America adopted their government, and must have been contemplated in forming it."[43] Marshall cautioned, however, that the delegated powers under the commerce clause presuppose some powers not delegated, and then set about defining the scope of Congress's delegated–and conversely the scope of the states' reserved–powers. Thus, Marshall stated:

> The enumeration presupposes something not enumerated; and that something, if we regard the language or the subject of the sentence must be the exclusively internal commerce of a State. The genius and character of the whole government seem to be, that its action is to be applied to all the external concerns of the nation, and to those internal concerns which affect the States generally; but not to those which are completely within a particular State, which do not affect other States, and with which it is not necessary to interfere, for the purposes of executing some of the general powers of the government. The completely internal commerce of a State, then, may be considered as reserved for the State itself.[44]

Marshall's analysis was in large part motivated by the then-dominant conception of federal and state powers residing in discrete–and thus mutually exclusive–spheres.[45] The central theoretical problem that such a supposition posed was that there were numerous state laws–typified for example by inspection laws–that limited the flow of goods in commerce, but that were widely understood to operate as valid exercises of state police powers. Chief Justice Marshall and Justice Johnson, who wrote separately, agreed on two points: first, that the New York license should be struck down, and second, that striking down the New York license should not threaten traditional exercises of state police powers in general, and inspection laws in particular.

Marshall's analysis and language–focusing on intercourse–was intended to suggest that commerce did not take place at the boundaries of the states, but necessarily pierced the border of

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[42]22 U.S. at 68.

[43]*Id.* at 68.

[44]*Id.* at 69.

[45]This thinking was motivated in large part by the issue of slavery. In Mayor of New York v. Miln, 36 U.S. (11 Pet.) 102 (1837) and in The Passenger Cases, 48 U.S. (7 How.) 283 (1849), the Court was called upon to address the permissible extent of state powers in regulating the slave trade. In *Miln*, the Court treated the subject matter as one of state police powers, thus allowing a state to require shipmasters to report the names and residences of passengers. And in *The Passenger Cases*, a split Court struck down, among other things, a state statutory provision that imposed a per-passenger tax used to defray the cost of health inspections and treatment of incoming passengers on a slave ship. Provided the regulatory power resided in the states, southern states had an incentive to support the mutually exclusive powers model. But once the Court determined the subject area to be national, the same states were motivated to argue for the abandonment of the exclusive powers model in favor of one that allowed concurrent regulation.

the states, and sometimes passed entirely through states. This notion, when combined with the late eighteenth century understanding of powers residing in discrete and isolated spheres, might have suggested that Congress's commerce clause power–which in this case had already been exercised–threatened to diminish or even to eliminate traditional state police powers that touched upon goods destined for commerce. Marshall avoided this problem through an analytical ploy that can rightly be characterized as formalistic. And his analytical technique continues to influence debates over the scope of Congress's commerce clause powers. For Marshall, inspection laws were carved out of the scope of commerce powers because they "act upon the subject *before* it becomes an article in foreign commerce."[46]

Justice Johnson, in contrast, rested his analysis on the nature of the underlying state law, rather than on a timing-based conception of when goods are or are not in commerce. Thus, Johnson asserted that while inspection laws touch on goods in a noncommercial capacity, by ensuring that goods destined for commerce are safe and that goods that are noxious are stopped in their tracks and quarantined, the same could not be said about the New York licence.[47] The license was ultimately a prohibition against all others who would seek to navigate waters between New York and New Jersey. The nature of the New York license was therefore commercial, and thus off limits without regard to whether Congress had acted in the first instance. The positions of the two justices are summarized in Table 1 below:

Table 1: Marshall and Johnson Frameworks in *Gibbons v. Ogden*

	Pre-Commerce	In Commerce
Commercial Regulation		*New York License*
Non-Commercial Regulation	*inspection laws*	

In the Marshall formulation, inspection laws operated pre-commerce, and thus fell within the valid bounds of state powers represented in the left hand side of the four box matrix. In contrast, in the Johnson formulation, such laws were valid because they operated in the lower half of the same four box matrix. Because the lower left box overlaps in these two conceptions, we can place the our hypothetical inspection laws in that box, consistent with the competing analyses of both jurists. In addition, both Marshall and Johnson voted to strike down the New York license, again for competing reasons that allow us to identify an overlapping box in Table 1. For Marshall, the New York license operated in an area in commerce, and since Congress chose to regulate it, the contrary state law had to yield. This places the actual case in the right two boxes. But for Johnson, because the state law was commercial in nature, it was invalid without regard to whether Congress had acted, thus placing it in the top two boxes. Because these categorizations again overlap, this time in the upper right box, we can place the actual case facts there in a manner consistent with both opinions. In short, because the debate between Johnson and Marshall allowed both to maintain their preferred positions with respect to the immediate case and the most significant hypothetical that they envisioned, it was unnecessary to

[46] *Id.* at 72 (emphasis supplied).
[47] *Id.* at 79 (Johnson, J., concurring).

the outcome of *Gibbons* for the Court to resolve these two competing visions of the commerce clause. And the next time that Marshall was presented with an opportunity to strike down a state law on dormant commerce clause grounds, he declined, holding that the state law in question was a valid exercise of state police powers.[48]

The Taney Court further considered the question whether the commerce clause imposed a judicially enforceable negative prohibition on states. As with the Marshall Court, it expressed its affirmative answer in the form of dictum. In *Cooley v. Board of Wardens*,[49] the Court addressed the constitutionality of a Pennsylvania statute, dating to 1803, that required local pilots on ships entering or leaving the port of Philadelphia. Operating in the background of the case was a federal 1789 statute that provided for local regulation of pilotage unless Congress sought to impose a uniform rule in the future. The Court did not consider the federal statute controlling, however, because under the then-dominant thinking about the separate spheres of federal and state powers, if the regulation of pilotage was local, Congress lacked the power to regulate in any event, and if it was national, it remained unclear whether Congress had the power to delegate that power back to the states.[50] But the Court observed that the federal statute did "manifest . . . the understanding of Congress"[51] that regulation of pilotage was not such as to require exclusive federal regulation.

Unlike the earlier Marshall Court opinions, Justice Curtis, writing for a majority, determined that the state pilotage law did regulate an aspect of commerce. But the Court went on to qualify, stating:

> [The] power to regulate commerce, embraces a vast field, containing not only many, but exceedingly various subjects, quite unlike in their nature; some imperatively demanding a single uniform rule, . . and some, like the subject now in question, as imperatively demanding that diversity, which alone can meet the local necessities of navigation.[52]

The Court went on to articulate the following famous–if not terribly helpful–formulation:

> Whatever subjects of this power are in their nature national, or admit only of one uniform system or plan of regulation, may justly be said to be of such a nature as to require exclusive legislation by Congress. That this cannot be affirmed of laws for the regulation

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[48]In Wilson v. Black Bird Creek Marsh Co., 2 Pet. (27 U.S. 245) (1829), a federally licensed sloop broke and injured a dam on a creek that flowed into the Delaware River, and that was erected under the authority of Delaware law. In defending against a suit for the resulting damages, Wilson claimed that the state law authorizing the dam violated the commerce clause. In this case, Chief Justice Marshall found no clear preemption, and thus was forced to consider the question raised in Johnson's *Gibbons* analysis, namely whether in the absence of a federal statute, a state statute that interferes in some sense with interstate commerce is void under the commerce clause. In his short opinion for the Court, Marshall appeared to follow Johnson's lead in asking whether the regulation in question was commercial in nature. While Marshall conceded that had Congress chosen to regulate access through small navigable creeks, "we should feel not much difficulty in saying that a state law coming in conflict with such act would be void," 27 U.S. at 252, he also recognized the Delaware statute as an exercise of state police powers that had the effect of enhancing property values and of promoting the health of local inhabitants. In essence, Marshall appeared to recognize, perhaps in some tension with his earlier *Gibbons* analysis, that a challenged state law might be "commercial" for purposes of evaluating a preemption case (meaning in this instance that Congress has actually exercised its commerce clause powers), but "police" when Congress has failed to do so, and instead, when the Court must evaluate a state law under the commerce clause operating in its dormant capacity.

[49]12 How. (53 U.S.) 299 (1851).

[50]For a discussion of the linkage of this issue to slavery, see *supra* note 42.

[51]53 U.S. at 320.

[52]*Id.* at 319.

of pilots and pilotage is clear.[53]

Finally, in the first of two related Fuller Court opinions, both written by the Chief Justice, the Supreme Court for the first time struck down a state law based upon the dormant commerce clause, only to then, in the second case issued one year later, hold that Congress can confer upon states regulatory power over the same subject matter. In *Leisy v. Hardin*,[54] the Court applied the "original package doctrine"[55]–preventing states from taxing items shipped in original packages in interstate commerce–to strike down an Iowa law under which a local marshal seized kegs of beer that Leisy brewed in Illinois and shipped in original packaging to Iowa. Chief Justice Fuller held that although Iowa could regulate local liquor consumption, under the *Cooley* formulation, the Court could not allow the seizure to stand. The Court stated:

> Whenever [a] particular power of the general government is one which must necessarily be exercised by it, and Congress remains silent, this is not only not a concession that the powers reserved by the States may be exerted as if the specific power had not been elsewhere reposed, but, on the contrary, the only legitimate conclusion is that the general government intended that power should not be affirmatively exercised, and the action of the States cannot be permitted to effect that which would be incompatible with such intention.[56]

Within months of the *Leisy* decision, Congress passed the Wilson Act, which effectively exempted liquor traveling interstate from the original package doctrine. Even though in *Leisy*, Fuller had stated that taxing originally packaged liquor violated the dormant commerce clause on the ground that the subject matter demands the application of a uniform national rule, in *In Re Rahrer*,[57] he proceeded to sustain the Wilson Act. In the latter case, Fuller stated that "[no] reason is perceived why, if Congress chooses to provide that certain designated subjects of interstate commerce shall be governed by a rule which divests them of that character, at an earlier period of time than would otherwise be the case, it is not within its competence to do so."[58] This awkward circumlocution later became unnecessary, once the Court abandoned the notion that commerce could be delineated as inherently national or local, and thus that the respective powers of Congress and the states could not overlap. But even with this later jurisprudential refinement, the combined *Cooley*/*Leisy*/*Rahrer* regime helps to frame the modern dormant commerce clause analysis.

Table 2 summarizes the discussion:

Table 2: Commerce Categories

	Congress Regulates	Congress Silent	Congress Delegates

[53] *Id.* While the Court appeared to reject the national/local distinction in favor of the inquiry whether the challenged statute affected commerce "only indirectly, incidentally, and remotely," see Smith v. Alabama, 124 U.S. 465 (1888), the Court has continued to draw upon both formulations.

[54] 135 U.S. 100 (1890).

[55] The Court articulated this doctrine in Brown v. Maryland, 25 U.S. (Wheat.) 419 (1827), and then restricted its use in Tire Co. v. Wages, 423 U.S. 276 (1976).

[56] 135 U.S. at 109.

[57] 140 U.S. 545 (1891).

[58] 140 U.S. at 561.

<table>
<tr><td>Inherently National (direct)</td><td>States cannot act
(per Gibbons v. Ogden)</td><td rowspan="2">States cannot act

Cooley

States can act</td><td>States can act
(per In re Rahrer)</td></tr>
<tr><td>Inherently Local (indirect, incidental, or remote)</td><td>States cannot act (but see New York v. United States; United States v. Lopez)</td><td>[irrelevant cell]</td></tr>
</table>

While the first column, which treats the subject matter of the Congressional commerce clause powers, and the third cell, which treats the subject matter of Congressional delegation, are not the central concern of this article, filling in these cells will help to provide the necessary context for the analysis to follow. The upper left box is easily handled by *Gibbons* itself. In that case, the Court held that if Congress regulates in an area that is inherently national, the federal statute will preempt a contrary state law, and thus states cannot act. The lower box in the first column is more problematic. To flesh out that box, which is now complicated by such cases as *New York v. United States*,[59] and *United States v. Lopez*,[60] we must briefly consider the Court's commerce clause jurisprudence.

B. A Brief Excursion on Congressional Commerce Clause Powers

Beginning in the New Deal and continuing until the mid to late 1990s, the Supreme Court had all but abandoned a narrow construction of the commerce clause coupled with a broad reading of the 10th amendment to limit Congressional regulation of commerce. In this roughly sixty-year period from the mid 1930's to the mid 1990's, the Court sustained nearly all exercises of Congressional commerce clause powers regardless of the local nature of the underlying subject matter,[61] or the seemingly attenuated connection to commerce.[62] While the Court's permissive use of the commerce clause generated strong dissents among conservative jurists and academic commentators, it was not until the 1992 decision in *New York v. United States*,[63] that the Court, for the first time in nearly six decades, struck down a federal statute as extending beyond federal commerce clause powers, or conversely, as violating the tenth amendment.[64]

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[59]505 U.S. 144 (1992).

[60]514 U.S. 549 (1995).

[61]The most famous cases are NLRB v. Jones & Laughlin Steel Co., 301 U.S. 1 (1937) (abandoning temporal formalism in upholding the National Labor Relations Act as applied in a large scale manufacturing context); Wickard v. Filburn, 317 U.S. 111 (1942) (upholding application of production quota under the Agricultural Adjustment Act to a farmer growing wheat for his own consumption); Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528 (1985) (upholding application of Fair Labor Standards Act to municipal transit authority and overruling National League of Cities v. Usery, 426 U.S. 833 (1976), which had exempted "areas of traditional governmental functions" under a four-part test).

[62]*See, e.g.,* Heart of Atlanta Motel v. United States, 379 U.S. 241 (1964) (sustaining the public accommodations provisions of the 1964 Civil Rights Act to prohibit discrimination against African Americans by a hotel under the commerce clause, thus avoiding the difficult state action problems that threatened to arise if the Court instead relied upon Congressional enforcement powers under the 14th amendment); Katzenbach v. McClung, 379 U.S. 294 (1964) (same as applied to a restaurant).

[63]*See* New York v. United States, 505 U.S. 144 (1992).

[64]505 U.S. at 156 ("In a case like these, involving the division of authority between federal and state governments, the [10th amendment and commerce clause] inquiries are mirror images of each other.").

The *New York* holding was narrow and did not rest upon a finding that Congress had improperly regulated a subject area off limits to it under the commerce clause due to its inherently local nature. And in fact, there is little question that the subject matter–the disposal of low level radioactive waste–fell squarely within the proper scope of Congressional commerce powers. Instead, the Court objected to a coercive tactic employed in a federal statute, which imposed draconian sanctions upon states that did not become self sufficient in storing low level radioactive waste in a manner consistent with a series of progressive deadlines, either by siting a waste facility in state or by joining a regional pact. While she had previously suggested that federalism is designed to limit excessive governmental powers,[65] in *New York v. United States*, Justice O'Connor, writing for a majority, held for the first time that Congress lacks the power to "commandeer" state legislatures. The anticommandeering doctrine holds that while Congress can create incentives, for example by linking the receipt of federal funds to the passage of certain state law programs, and while Congress can threaten states that if they do not undertake a favored program, Congress will preempt contrary state regulations, Congress otherwise lacks the constitutional power to force states to regulate on its behalf.[66] Three years later, the Court issued a far more important decision suggesting a meaningful limit for the first time since the New Deal on Congress's commerce clause powers based on subject matter.

In the 1995 decision, *United States v. Lopez*,[67] the Court, in an opinion by Chief Justice Rehnquist, struck down the Gun Free School Zones Act of 1990, which had made it a federal crime to knowingly possess a gun in a place that the person knows or has reason to believe is a school zone. In doing so, the Court suggested a far more significant set of restrictions on Congress's use of commerce clause powers, asserting that the prior expansive use of powers could be placed into three categories, "the channels of interstate commerce," "the instrumentalities of interstate commerce, or persons or things in interstate commerce," and "economic activities" that "substantially affect interstate commerce."[68] The *Lopez* Court determined that however expansive prior commerce clause jurisprudence had been, and without overruling any earlier cases, the challenged statute extended beyond the permissible limits of Congress's commerce clause powers.[69]

Lopez is relevant in two respects. First, it requires a qualification in what once had been a

[65] *See, e.g.,* Gregory v. Ashcroft, 501 U.S. 452 (1991) ("Perhaps the principal benefit of the federalist system is a check on abuses of government power."); *id.* ("The constitutionally mandated balance of power between the States and the Federal Government was adopted by the Framers to ensure the protection of our fundamental liberties.") (internal quotations omitted).

[66] The Court subsequently extended this principle in Printz v. United States, 521 U.S. 898 (1997) (holding that the Brady Act, which required state chief law enforcement officers to perform background checks on prospective gun purchasers violated anticommandeering principal even though act directed executive officers rather than state legislatures.); *but see* Reno v. Condon, 528 U.S. 141 (2000) (employing quasi-market participant analysis to reject anticommandeering challenge to Driver's Privacy Protection Act, which regulates disclosure of personal information from records of state motor vehicle departments).

[67] 514 U.S. 549 (1995).

[68] *Id.* at 557.

[69] More recently, in *United States v. Morrison*, 120 S.Ct. 1740 (2000), the Court extended *Lopez* to strike down a provision in the Violence Against Women Act, which provided a civil remedy against any person "who commits a crime of violence motivated by gender." As in *Lopez*, the Court ruled out the first two categories easily, and determined that to fit the statute into the third would require abandoning the distinction between that which is "truly national and . . . [that which] is truly local."

clear presentation in the lower box under column one. Up until *Lopez*, one could represent with some certainty that if Congress regulates under the commerce clause, then the states could be prevented from enacting a contrary regulation, even if the subject area appeared to be inherently local. Without suggesting that the pre-*Lopez* regime was one without limits on Congressional powers, one could confidently represent that the Court had not yet found them. In *Lopez*, Chief Justice Rehnquist did not claim to change pre-existing commerce clause doctrine, but there is little question that some revisionism attended his effort to squeeze the expansive jurisprudence in that area into three doctrinal categories into which the challenged statute did not fall. For present purposes it is sufficient to observe that while Congress retains considerable commerce clause powers, those powers are now subject to some limitations that are intended to exclude regulation of inherently local activity. Second, and perhaps more importantly, the *Lopez* categories are notable for the dormant commerce clause cases that follow. As one commentator has recently observed: "[M]ost [dormant commerce clause] cases involve conduct that, were it regulated by Congress, would be considered regulation of either the *channels* of interstate commerce (and things or persons moving therein) or of *instrumentalities* of interstate commerce–the least controversial of *Lopez*'s taxonomy of congressional commerce power."[70] The discussion of the principal dormant commerce clause cases in the next subpart is consistent with this assertion.

Before discussing the second column in Table 2, let us briefly turn to the third. The lower right cell is uninteresting. If a subject area is inherently local, then there is simply no need for Congress to delegate as a precondition to a state's exercise of regulatory power in that area. The upper right cell is important, and became analytically problematic in large part due to Chief Justice Marshall's formalistic conception of commerce expressed in *Gibbons*, namely the idea that federal and state powers with respect to commerce reside in discrete and non-overlapping spheres. If a power was truly national, then as suggested in *Leisy*, it admitted of only a uniform rule. And while the Court need no longer rely upon Fuller's awkward formalism, asserting that Congress can divest objects of their character in commerce, Fuller's ultimate holding in *In re Rahrer*,[71] that Congress can delegate to states the power to regulate an area that would otherwise have been deemed inherently national, remains good law. As a result, it is sufficient to note that Congress has full power to delegate to the states regulatory authority over commerce, subject to the caveat that any resulting state law will remain subject to independent constitutional checks.[72]

C. Return to the Dormant Commerce Clause: The Modern Era

We have now established not only the doctrinal context for the middle column in Table 2 (state regulatory powers in the face of Congressional silence), which represents the principal focus of this article, but also the nature of permissible federal regulations of commerce against which illicit state interference with commerce is most obviously compared. When Congress is silent, under the *Cooley* formulation it devolves to the federal courts to determine whether a challenged state law falls into a subject area that is inherently local, thus remaining within state

[70]Brannon P. Denning, *The Dormant Commerce Clause Doctrine and Constitutional Structure* (working paper on file with author).

[71]140 U.S. 545.

[72]For a case that illustrates this proposition, see Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869 (1985) (striking down Alabama's differential tax scheme on insurance based upon equal protection notwithstanding federal statute enacted pursuant to the commerce clause delegating regulatory power over insurance to states).

powers, or inherently national, thus removed from state powers unless Congress delegates that power to the states. But as we have already seen, the Court has abandoned its once dominant jurisprudential conception–prevalent throughout the late 18th and 19th centuries–that unless otherwise clear from context, for example in area of taxation,[73] the respective spheres of federal and state power are presumed to be hermetically sealed. As a result, even before we review the modern dormant commerce clause cases, we can appreciate the difficulty that the Court inevitably confronts in trying to classify challenged laws according to whether they touch on a matter that is inherently national, or commercial, in nature, or, as subsequently expressed, whether it only touches upon commerce "only indirectly, incidentally, and remotely."[74] Because the categories of police powers and commercial regulatory powers necessarily overlap, any implicit limitation derived from the commerce clause on state powers threatens to undermine its functioning in traditional regulatory areas.[75] It is for that reason, I would suggest, that the Court's doctrinal formulations often appear inadequate in explaining the contours and import of the dormant commerce clause doctrine.[76] Only after we have reviewed the relevant cases arising

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[73]The area of concurrent taxation is noteworthy in that in the chestnut decision, McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819), Chief Justice Marshall, while acknowledging that taxation powers were concurrent, employed a process-based argument drawn from political theory suggesting that if individual state legislatures, which answer to a constituency that represents a subset of that for the nation as a whole, were permitted to tax a national entity individually or collectively, the state taxation power could then be exercised so as to destroy. In his recent article, *see* Denning, *supra* note 67, Professor Denning argues that the same analysis provides at least a partial rejoinder to those who read Hamilton's Federalist 32 narrowly to argue against an original understanding consistent with construing the commerce clause to operate in a dormant capacity. As Denning argues, the same difficulty with vesting a subpart of the whole with power to tax an entity of the whole applies in allowing subparts of the whole to regulate commerce as it affects the whole. While Denning does not construct, or rely upon, game theory in setting forth his argument, his structural analysis is largely consistent with the model developed in part III.

[74]Smith v. Alabama, 124 U.S. 465, 482 (1888).

[75]To fully appreciate this point, it is worth remembering a critical distinction between federal and state constitutional structures. The United States Constitution operates on a stripping and vesting model. Powers are stripped from the states, and vested on the various branches of the federal government or in the federal government generally. In this model, Congress is presumed to lack power absent a proper constitutional hook, and it is further subject to independent constitutional constraints. In contrast, state constitutions are premised upon a plenary powers model. State legislatures are presumed to have power unless limited by the constraints imposed by the state or federal constitutions, or by virtue of the Supremacy Clause, laws enacted pursuant to the federal constitution. *See* Maxwell L. Stearns, *The Misguided Renaissance of Social Choice*, 103 YALE L. J. 1219, 1258 n.10 (1994); *see also* James E. Costello, *The Limits of Popular Sovereignty: Using the Initiative Power to Control Legislative Procedure*, 74 CAL. L. REV. 491, 553 n.329, 554 (1986). As suggested in the text, especially in a regime of overlapping powers, the dormant commerce doctrine holds great significance for this combined constitutional scheme. The Tenth Amendment admonition that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people," U.S. CONST. AM. X, is less meaningful if the limitations on plenary state legislative powers, especially those understood to operate in the area of traditional police powers, derive from implicit limits imposed by the Commerce Clause operating in its dormant capacity, in addition to the explicit limits imposed through Congress's already broad exercise of power under that expansive clause.

[76]This is especially true in the core cases falling into the multiple Nash equilibrium category, namely *Kassel* and *Bibb*. *See infra* parts II.C.2.b (explaining anomalies that cases represent under the Court's own doctrinal

under the dormant commerce clause and related doctrines–market participation, export taxation, and Article IV privileges and immunities–will we be prepared for the game theoretical framework that I suggest will help to explain these cases and to provide a sounder normative foundation for some of their most criticized features.

In contrast with the prior subpart, the presentation in the section that follows is not presented in historical sequence. Instead, I will discuss cases that are most helpful in setting forth the Court's doctrinal formulations for the major case categories, and then introduce other cases, and doctrines, that reveal the apparent inconsistencies, and limits, of the Court's articulated doctrinal formulations. The presentation is not comprehensive. I will add cases and details to the discussion in Part IV. Instead, my purpose is to establish both the basic doctrinal framework and to expose the apparent inconsistencies in applying that framework that have given rise to the widespread criticism of the dormant commerce clause both on the Court and among constitutional scholars.

We will begin with *City of Philadelphia v. New Jersey*,[77] a well known case involving facial discrimination in the increasingly important–and litigious–area of waste disposal.[78] Because this case helps to set up multiple doctrinal categories, I will quote somewhat more extensively from it than from the cases that follow.

1. Statutes that Facially Discriminate in Commerce

a. Waste Import Restrictions and Environmental Protection

In *City of Philadelphia v. New Jersey*,[79] New Jersey prohibited importing most "solid or liquid waste,"[80] originating from out of state. The state supreme court sustained the law against a commerce clause challenge by, among others, private landfill operators, concluding that it "advanced vital health and environmental objectives."[81] On appeal, the Supreme Court determined that there was no controlling federal statute, and thus no preemption.[82] Thus, the case arose under the commerce clause operating in its dormant capacity.

Justice Stewart, writing for a majority, began by rejecting the state's argument that the negative value of waste prevents it from being a commodity in commerce.[83] Stewart then

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framework) and IV.B.2.a (recasting cases based upon multiple Nash equilibrium analysis developed in part III).

[77]437 U.S. 617 (1978).

[78]The proliferation of waste-related cases is well captured in the statement by Judge Cabranes that the federal judicial docket has become "clogged . . . with garbage." *See* SSC Corp. v. Smithtown, 66 F.3d 502, 505 (2d Cir. 1995).

[79]437 U.S. 617.

[80]*Id.* at 618.

[81]*Id.* at 620.

[82]*See id.*

[83]437 U.S. at 622 ("[All] objects of interstate trade merit Commerce Clause protection; none is excluded by definition at the outset. Hence, we reject the state court's suggestion that banning of 'valueless' out-of-state wastes .

articulated his vision of the role of the federal courts in dormant commerce clause cases:

> Although the Constitution gives Congress the power to regulate commerce among the States, many subjects of potential federal regulation under that power inevitably escape congressional attention 'because of their local character and diversity.' . . . In the absence of federal legislation, these subjects are open to control by States so long as they act within the restraints imposed by the Commerce Clause itself.[84]

Justice Stewart then relied upon Justice Jackson's famous articulation, expressed in *H.P. Hood & Sons v. DuMond*,[85] of the object of the Court's dormant commerce clause jurisprudence:

> [The] principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units. . . .
>
> The material success that has come to inhabitants of the states which make up this federal free trade unit has been the most impressive in the history of commerce, but the established interdependence of the states only emphasizes the necessity of protecting interstate movement of goods against local burdens and repressions.
>
> Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.[86]

Relying upon *H.P. Hood & Sons*, Justice Stewart then asserted that "where simple economic protectionism is effected by state legislation, a *virtual per se rule of invalidity* has been erected."[87] Stewart noted that the clearest examples of such laws "overtly block[] the flow of

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. . implicates no constitutional protection."). In the more recent decision, C & A Carbone, Inc. v. Clarkstown, 511 U.S. 383 (1994), the Court struck down a flow control ordinance that required all waste generated within Clarkstown to be deposited at a specified waste transfer station, which would then collect a fee exceeding the cost of disposal, as a means of financing the station's construction. In that case, Justice Kennedy, writing for a majority and striking down the challenged statute, provided a more obvious justification for treating waste as commerce:

> As the town itself points out, what makes garbage a profitable business is not its own worth but the fact that a processor must pay to get rid of it. In other words, the article of commerce is not so much the solid waste itself, but rather the service of processing and disposing of it.

511 U.S. at 390-91.

[84]*City of Philadelphia*, 437 U.S. at 623.

[85]336 U.S. 525 (1949).

[86]336 U.S. at 537-38. Justice Stewart quoted only the first paragraph of the block quote as it appears in the text. *See City of Philadelphia*, 437 U.S. at 623. For a discussion of Professor Bittker's description of the Jackson quote as stretching history, see BORIS I. BITTKER, BITTKER ON THE REGULATION OF INTERSTATE AND FOREIGN COMMERCE § 6.06, 6-35-36 (1999).

[87]437 U.S. at 624 (emphasis supplied).

interstate commerce at the State's borders."[88] He added, however, that "where other legislative objectives are credibly advanced and there is no patent discrimination against interstate trade, the Court has adopted a more flexible approach."[89]

Stewart then quoted the balancing test initially articulated by Justice Stone first articulated in *Pike v. Bruce Church*[90]:

> Where the statute regulates evenhandedly 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.[91]

In *City of Philadelphia*, Justice Stewart did not obviously apply either the per se rule of invalidity or the balancing test as articulated in *Pike*. He began his analysis by evaluating the state's contention that the statute was motivated primarily by environmental rather than financial concerns. The New Jersey Supreme Court had found that the statute was environmentally motivated, citing as support findings in the legislative history concerning the environmental toll resulting from the shortage of landfill space.[92] The State refuted the allegation that the statute was financially motivated, observing that New Jersey landfill operators were among the plaintiffs and that no commercial in state interests obviously stood to gain from the regulation.[93] In contrast, appellants challenged the statute by relying upon statements in the legislative history that pointed to the need to extend the life of local landfills to delay "the day when New Jersey cities must transport their waste to more distant and expensive sites."[94] For Stewart, it was not necessary to resolve the dispute: "[W]e assume that New Jersey has every right to protect its residents' pocketbooks as well as their environment."[95] Stewart added:

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[88]*Id.*

[89]*Id.*

[90]397 U.S. 137, 142 (1970). Professor Regan has argued that at the time of his article, all but one major Supreme Court dormant commerce clause case in the movement of goods category that purported to apply this, or some other, balancing test, could be best explained without the use of balancing by inquiring whether the Court found appropriate proxies for purposeful discrimination and that Justice Stone was the only true balancer on the Court. *See* Regan, *supra* note 32. Regan concedes that the Court does employ a form of balancing in transportation cases, which are not the primary subject of his article.

[91]*City of Philadelphia*, 437 U.S. at 624; *see also* Raymond Motor Transp., Inc. v. Rice, 434 U.S. at 441-42 (articulating balancing test).

[92]437 U.S. at 625.

[93]*Id.* at 626.

[94]*Id.*

[95]*Id.*

> This dispute about ultimate legislative purpose need not be resolved, because its resolution would not be relevant to the constitutional issue to be decided in this case. Contrary to the evident assumption of the state court and the parties, the evil of protectionism can reside in legislative means as well as legislative ends.[96]

Instead, the problem [was] New Jersey's chosen method of advancing those interests. Justice Stewart distinguished cases involving the quarantine of noxious goods, observing that "quarantine laws ban[] the importation of articles such as diseased livestock that require[] destruction as soon as possible because their very movement risk[s] contagion and other evils."[97] Rather than discriminating in commerce, such laws "simply prevent[] traffic in noxious articles, whatever their origin."[98] The difficulty in this case, however, is that New Jersey affected a patent discrimination based upon point of origin without having a "reason, apart from their origin, to treat them differently."[99] Stewart then observed that New Jersey could, if it so chose, close off its landfills to waste altogether, whether from within or without the state. Quoting *Foster-Fountain Packaging Co. v. Haydel*,[100] Stewart then added: "[A] State is without the power to prevent privately owned articles of trade from being shipped and sold in interstate commerce on the ground that they are required to satisfy local demands or because they are needed by the people of the state."[101] As a result, Stewart concluded that "[t]he New Jersey law at issue . . . falls squarely within the area that the Commerce Clause puts off limits to state regulation."[102]

The *City of Philadelphia* decision thus presents something of an ambiguity as to the test it

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[96] *Id.*

[97] *Id.* at 628-29.

[98] *Id.*

[99] *Id.* at 626.

[100] 278 U.S. 1 (1928).

[101] *City of Philadelphia*, 437 U.S. at 627 (quoting Foster-Fountain Packaging Co. v. Haydel, 278 U.S. at 10).

[102] 437 U.S. at 628. Stewart added that there is a sense of fair play that underlies the Court's ruling: "Tomorrow, cities in New Jersey may find it expedient or necessary to send their waste into Pennsylvania or New York for disposal, and those States might then claim the right to close their borders." *Id.* at 629. Writing in dissent, then-Associate Justice Rehnquist observed that the ruling appeared to present what he regarded to be an unwarranted Hobson's choice:

> New Jersey must either prohibit *all* landfill operations, leaving itself to cast about for a presently nonexistent solution to the serious problem of disposing of the waste generated within its own borders, or it must accept waste from every portion of the United States, thereby multiplying the health and safety problems which would result if it dealt only with such wastes generated within the State.

Id. at 631 (Rehnquist, J., dissenting). For an article that is sympathetic to the Rehnquist dissent and that argues that the Court's dormant commerce clause doctrine, especially as applied in the waste disposal cases, is premised upon an erroneous set of premises drawn from neoclassical economics, rather than a better suited prisoners' dilemma model, see Paul E. McGreal, *The Flawed Economics of the Dormant Commerce Clause*, 39 WM. AND MARY L. REV. 1191 (1998).

applies in striking down the waste import restriction. While the Court articulated two rules, the per se rule of invalidity and the balancing test, it is not clear which, if either, of these tests the Court actually applied. The problem is that while the statute at issue was facially discriminatory against commerce, it was coupled with an interest that the Court acknowledged to be legitimate for the state to pursue, albeit not by the chosen means. This leaves open the possibility that when the fatal defect is the means chosen, the applicable standard might not be the per se rule, but rather a kind of strict scrutiny, which the Court hints at but does not fully articulate in its opinion. Rather than merely balancing the possibility of a nonrestrictive alternative, the Court might have demanded the absence of such a possible alternative as a preconditioning to sustaining the challenged law. The following cases will help to determine when such a rule, which more closely resembles strict scrutiny than a balancing test, applies and whether this test provides a better reading of *City of Philadelphia.*

We will begin with another case evaluating a statute that overtly blocks the flow of commerce, in which the Court expressly applied the "strictest scrutiny,"[103] but then proceeded to uphold the challenged law. In *Maine v. Taylor*,[104] the Court considered a Maine statute that prohibited the import of live baitfish from out of state where the out-of-state fish commonly had parasites that represented a danger to native Maine fish and where the parasite was not common in state.[105] The Court stated that "once a state law is shown to discriminate against interstate commerce either on its face or in practical effect, the burden falls on the State to demonstrate both that the statute serves a legitimate local purpose, and that this purpose could not be served as well by available nondiscriminatory means."[106] Because this statute expressly discriminated in commerce, the Court determined that it was appropriate to apply "strictest scrutiny."

In this case, the Court determined that the test was met:

> [First,] Maine's population of wild fish–including its own indigenous golden shiners–would be placed at risk by three types of parasites prevalent in out-of-state baitfish, but not common to wild fish in Maine. . . . Second, nonnative species inadvertently included in shipments of live baitfish could disturb Maine's aquatic ecology to an unpredictable extent by competing with native fish for food or habitat, by preying on native species, or by disrupting the environment in more subtle ways.[107]

While the Court purported to apply strict scrutiny, under which the state bears the burden of

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[103]Maine v. Taylor, 477 U.S. 131, 144 (1986) (quoting Hughes v. Oklahoma, 441 U.S 322 (1979)).

[104]477 U.S. 131.

[105]Maine v. Taylor, 477 U.S. 131, had a peculiar procedural history. Taylor was convicted under a federal statute that prohibited interstate shipments in violation of federal or state law. Taylor defended claiming that the Maine statute prohibiting the importation of live baitfish violated the commerce clause, thus providing an unconstitutional state law predicate for his federal prosecution. While the court of appeals reversed his conviction on that basis, the State of Maine intervened to defend the constitutionality of its own statute on appeal to the Supreme Court. *Id.* at 133. Even though as to Taylor the case was moot, the Supreme Court found that Maine could invoke the Supreme Court's jurisdiction under 28 U.S.C. § 1254(2) to defend the constitutionality of its statute. *Id.*

[106]*Id.* at 138 (internal quotations omitted).

[107]*Id.* at 141.

proof, it determined that the unique problem posed by imported live baitfish demonstrated the absence of a neutral, nondiscriminatory alternative, and thus upheld the facial restriction on commerce.

Maine v. Taylor is significant for two points. First, it establishes that even in a case involving facial discrimination against out of state commerce, the Court does not necessarily apply the per se rule of invalidity. Instead, if the state provides a justification that is not protectionist or financially motivated, the Court will inquire whether the justification is legitimate and whether it can be advanced in a nondiscriminatory manner.[108] In *Maine*, the Court deferred to the district court's determination that both prongs were met.[109] Second, the case provides an important additional datum in reading *City of Philadelphia*. If we assume, as New Jersey claimed, that its waste import restriction was motivated by concerns for environmental protection and the desire to preserve landfill space, then the question arises whether the chosen means satisfy the Court's strict scrutiny test. Framing the issue in this manner reveals that even without applying the per se rule, the Court would likely have achieved the same result under the test articulated in *Maine.*[110] New Jersey could have achieved its legitimate environmental goal–but not its financially motivated goal of benefitting only the citizens of New Jersey at the expense of commerce–by reducing waste intake in its landfill sites by specified percentages each year, and by providing access on a first come first served basis without regard to the waste's point of origin. While the *City of Philadelphia* Court articulated the per se rule and the balancing test, its ruling can be rested consistently upon an application of this strict scrutiny test.

We will now consider one more context of facial discrimination in commerce, which the Court has prohibited, unless pursuant to a Congressional delegation. The case that follows involves a state law that appears to facilitate free trade with neighboring states by conditioning access to their goods or services upon a reciprocal grant of free trade from the partnering state. Despite the apparent pro-trade nature of the statute, the Court struck it down.

a. The Reciprocity Doctrine

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[108]It is worth noting that while the requirement that the objectives cannot be achieved in a nondiscriminatory manner was arguably met, as Justice Stevens observed in dissent it was possible to devise an alternative method that would achieve the articulated objective in a less discriminatory manner. *Id.* at 152-52 (Stevens, J., dissenting). If the state had set up a regime in which it inspected out of state live baitfish, it would have discriminated, but would have allowed some such fish to be imported.

[109]*Id.* at 140.

[110]For another case that like *City of Philadelphia v. New Jersey*, articulated the per se rule of invalidity, but instead turned upon the availability of a less discriminatory alternative, see *C & A Carbone, Inc. v. City of Clarkstown*, 511 U.S. 383. In that case, Justice Kennedy articulated the per se rule in striking down the city's waste transfer program, which required all waste that flows through the municipality to be processed at a waste transfer station, *see id.* at 392-93, but went on to articulate a nondiscriminatory "uniform safety regulations." *Id.* at 393. The availability of such an alternative would have been unnecessary had the per se rule actually applied. This suggests that as applied to facially discriminatory statutes for which the Court is able to identify a legitimate state purpose, the Court will apply strict scrutiny rather than the per se rule. This appears to apply as a general matter in dormant commerce clause cases involving environmental regulations.

In *Sporhase v. Nebraska*,[111] a Nebraska statute prohibited the withdrawal of groundwater from Nebraska wells intended for export to any state that failed to grant reciprocal water export rights to Nebraska. While the Court upheld other Nebraska water export restrictions requiring that the exports be "reasonable and not contrary to conservation"[112] on the ground that the state holds a proprietary interest in its scarce water supply, the Court applied strict scrutiny to the reciprocity provision, which it then struck down, holding that it was not "narrowly tailored" to further the state's conservation goals. The *Sporhase* Court relied upon an earlier reciprocity case, *A&P Tea Co. v. Cotrell*,[113] in which the Court asserted that reciprocity statutes were invalid even if intended to produce an incentive to eliminate trade barriers.[114]

The reciprocity doctrine appears peculiar because it is not obvious that reciprocity statutes fail strict scrutiny. While the state has a nondiscriminatory alternative, namely to mimic the law of the potential trade partner, such a strategy would threaten to undermine, rather than to promote, free trade. And yet, the Supreme Court has upheld such reciprocal trade provisions only in the limited context of a federal statute that conferred regulatory power over the underlying subject matter. Thus in *Western & Southern Life Ins. Co., v. State Bd. of Equalization*,[115] the Court sustained a reciprocity statute in the context of insurance, where Congress had delegated to the states regulatory power over the subject area.[116]

The Court has not only presumed against the constitutionality of laws that facially

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[111]458 U.S. 941 (1982).

[112]The challenged provision stated:

> Any person, firm, city, village, municipal corporation or any other entity intending to withdraw ground water from any well or pit located in the State of Nebraska and transport it for use in an adjoining state shall apply to the Department of Water Resources for a permit to do so. If the Director of Water Resources finds that the withdrawal of the ground water requested is reasonable, is not contrary to the conservation and use of ground water, and is not otherwise detrimental to the public welfare, he shall grant the permit if the state in which the water is to be used grants reciprocal rights to withdraw and transport ground water from that state for use in the State of Nebraska.

458 U.S. at 944.

[113]424 U.S. 366 (1976).

[114]In addition to the prisoners' dilemma analysis presented below, the tit for tat game provides a strong theoretical foundation to assuming that such statutes will have a benign effect in promoting trade. Assuming that the states are repeat trade players, then Robert Axelrod's study of tit for tat game suggests that reciprocity agreements–despite the facial discrimination–are more likely to promote open trade than to inhibit it. See ROBERT AXELROD, THE EVOLUTION OF COOPERATION (1984). So viewed, these statutes are likely to limit the power of interest groups to pursue restrictive trade measures because legislators will appreciate that catering to such pressures will impose direct costs on beneficiaries of imports from those states that carry the reciprocity provisions. And yet, the Court has disallowed such reciprocity agreements absent Congressional authorization. For a further discussion of reciprocity statutes, see *infra* part IV.B.3.c.

[115]451 U.S. 658 (1981).

[116]These cases thus raise the possibility of an interesting empirical verification of the Axelrod thesis in the context of reciprocal barriers to trade where Congress has allowed states to follow the strategy. *See* AXELROD, *supra* note 111, and cites therein. If reciprocal trade statutes in insurance have had the effect of loosening barriers to interstate insurance marketing, then this would provide an important empirical datum against the Court's presumed contrary rule in such cases as *Sporhase* and *A&P Tea Co.*

discriminate in commerce, but also against legislative efforts to conjoin provisions that would be independently constitutional, but that when put together have a clearly discriminatory effect only on out-of-state interests. The next case provides an illustration.

b. Tax and Rebates as the Functional Equivalent of Facially Discriminatory Statutes

In *West Lynn Creamery, Inc. v. Healy*,[117] Justice Stevens, writing for a majority, struck down a Massachusetts tax and rebate scheme for milk, where the tax operated neutrally on all milk sales, without regard to the milk's point of origin, but where the revenues went into a subsidy fund the proceeds of which were distributed solely to Massachusetts milk producers. In doing so, Justice Stevens provided one of the Court's clearest articulations of a political process, or representation reinforcement, justification for the dormant commerce clause, one that is parallel that more commonly associated with the famous *Carolene Products* footnote 4.[118] In essence this model holds that the Constitution's broadly worded provisions, especially equal protection, but as seen here also the commerce clause, should be construed to further the representation of those who are disadvantaged in the relevant political process.[119] Because out of state competitors are not represented in the Massachusetts legislature, a law that imposed an obligation solely upon them would appear to violate this norm. The relevant question for dormant commerce clause purposes is whether an in-state interest that is meaningfully represented in the political process ensures functional representation for the relevant out-of-state interests. In this case, the law appears neutral, but as Stevens notes, the combined regime in practical effect excludes those in state who would otherwise share a common set of interests with those who are not represented.

In applying the analysis to *Healy*, it is important to note what was not in dispute in the case. All justices in the case appeared to agree that had the component parts of the statute–the neutral tax measure and the subsidy program–arisen and been challenged separately, they would have withstood dormant commerce clause scrutiny. Even so, Justice Stevens struck down the combined regime:

> Nondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld, in spite of any adverse effects on interstate commerce, in part because "the existence of major in-state interests adversely affected . . . is a powerful safeguard against legislative

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[117] 512 U.S. 186 (1994).

[118] *See* United States v. Carolene Products, 304 U.S. 144, 152 n.4 (1938). For a sympathetic account of this jurisprudential analysis as applied to equal protection, see JOHN HART ELY, DEMOCRACY AND DISTRUST (1980). For a more critical assessment, see Laurence Tribe, *The Puzzling Persistence of Process-Based Political Theory*, 89 YALE L.J. 1063 (1980).

[119] It is important to note a major criticism leveled against this process-based political theory. The problem is that the appropriate level of participation that any particular group receives is a normative question that cannot be answered independently of the underlying substantive question whether the law subject to challenge is constitutionally permissible. Thus, if out-of-state interests are required to be included in a state's political processes, that effectively answers the question whether a state law that operates to the detriment of those interests will withstand constitutional scrutiny. But rather than directly confronting the question whether the law is or is not permissible, the representation reinforcement analysis side tracks this question by asking instead whether those who were harmed were adequately represented. For a general analysis of this analytical difficulty, see Einer Elhauge, *Does Interest Group Theory Justify More Intrusive Review?,* 101 YALE L.J. 1031 (1991). Elhauge observes that while this inquiry sounds content neutral, it has the nonneutral effect of simply masking an underlying substantive question.

> abuse." . . . However, when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a state's political process can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax has been mollified by the subsidy.[120]

Stevens concluded by observing that "[t]he purpose and effect of the pricing order are to divert market share to Massachusetts dairy farmers."[121]

Perhaps the easiest way to conceptualize this case is to appreciate that although the tax portion of the challenged law was neutral, the scheme as a whole was equivalent to a differential tax on milk imported from out of state, which was motivated by the desire to confer an advantage on the local milk industry at the expense of its out-of-state competitors. Had the statute taken that simpler form, there is little question that it would have been struck down under the per se rule of invalidity. So viewed, the case stands for the proposition that combined schemes that function as facially discriminatory schemes in practical effect will be subject to the per se rule, or at least to strict scrutiny.

We have now reviewed a sufficient body of case law to cover the essential framework for facially discriminatory statutes–or their operational equivalents–to which ordinary dormant commerce clause analysis applies. We will now turn to the body of dormant commerce clause case law that establishes the rules governing neutral state laws that allegedly burden commerce. After doing so, we will consider a group of cases, under the header of the market participant doctrine, that involve facially discriminatory statutes, but that have generally been exempted from dormant commerce clause analysis; an exception to the market participant doctrine that reinstates a kind of strict scrutiny; and a case that involves an alleged undue burden on commerce that is further exempt from dormant commerce clause analysis.

2. Facially Neutral Statutes that Burden Commerce

a. The Movement of Goods Cases

In *Hunt v. Washington State Apple Advertising Comm'n*,[122] the Supreme Court considered a dormant commerce clause challenge to a North Carolina statute, unique among all states, that prohibited the apples sold or shipped in North Carolina in closed containers to be identified with other than United States Department of Agriculture ("USDA") grading. North Carolina defended its statute as a necessary means of preventing fraud and consumer confusion in apple marketing. The Washington State Apple Commission challenged the statute on the ground that it burdened Washington apple growers by preventing them from using the alternative grading system pursuant to Washington law. Writing for a majority, Chief Justice Burger explained the burden that the North Carolina statute imposed on Washington apple growers as follows:

> [B]y prohibiting Washington growers and dealers from marketing apples under their State's grades, the statute has the leveling effect which insidiously operates to the advantage of local apple producers. [T]he Washington State grades are equal or superior to the USDA grades in all corresponding categories. Hence, with free market forces at work, Washington sellers would normally enjoy a distinct market advantage vis-a-vis

[120] 512 U.S. at 200.
[121] *Id.* at 203.
[122] 432 U.S. 333 (1977).

> local producers in those categories where the Washington grade is superior. However, because of the statute's operation, Washington apples which would otherwise qualify for and be sold under the superior Washington grades will now have to be sold under their inferior USDA counterparts. Such "downgrading" offers the North Carolina apple industry the very sort of protection against competing out-of-state products that the Commerce Clause was designed to prohibit.[123]

The critical datum in the Court's analysis involves the nature of the differential grading. The distinction is unlike translation from English to Spanish, which can generally be accomplished without significant loss of meaning.[124] Instead, as Burger observes, the Washington grading system was superior in all categories, meaning that the top grade under the Washington system was more stringent than the top grade in the USDA system. This is why the practical effect of the North Carolina statute was to downgrade Washington apples being marketed in North Carolina.[125] If we assume, as seems reasonable, that the relevant North Carolina apples are by and large indistinguishable within USDA Grade A, but that they are not adequate to meet the highest Washington standard, then it is easy to appreciate the burden on commerce that the North Carolina regime imposes.[126]

Chief Justice Burger further noted the potential nation-wide impact of the North Carolina order:

> In addition to its obvious consequence–prohibiting the display of Washington State apple

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[123]*Id.* at 351-52.

[124]Of course even there translation does not come without risk. For a somewhat ironic illustration, consider Castaneda v. Partida, 430 U.S. 482 (1977), a case in which the Court rejected a *Batson*-style challenge to struck Latino jurors, where the prosecutor defended against the charge that he exercised his peremptory challenges in a race-conscious manner on the ground that he feared that native Spanish speakers would have difficulty following official translations. If one considers that the proffered race-neutral rationale is that struck jurors will follow the actual meaning of testimony given in Spanish rather than potentially erroneous translations (when the translation is accurate this risk does not arise), the result seems peculiar. In fact, however, the result makes good sense when we realize that the purpose is to ensure that the jury follows proceedings preserved in the written record on appeal, which would not be the case if the jurors declined to follow official translations. And of course in the event of a false translation, the other side has the opportunity to raise appropriate objections, which will be preserved in the record.

[125]While the *Hunt* case assumed Washington apples to be superior, subsequent studies have revealed the Washington growers' focus on physical appearance to compromise taste. *See 'Perfect' Apple Pushed Growers Into Debt*, THE NEW YORK TIMES A.1 (Nov. 4, 2000) (quoting apple grower as stating: "Nobody should feel sorry for us – we did it to ourselves. . . . For almost 50 years, we've been cramming down the consumer's throat a red apple with ever thicker skin, sometimes mushy, sometimes very good if done right, but a product that was bred for color and size and not for taste."); Bob Kasper, *Big Red; In Apples, Color Doesn't Always Mean Quality*, CHICAGO TRIBUNE 3A (March 7, 2001) ("In the pursuit of a prettier, more uniform apple, . . . some Red Delicious apples have been bright red, but their flavor and crispness have suffered."). My own strong recommendation is Nitanny apples when they are available, even though they are not nearly as attractive.

[126]Revealed preferences appear to support, although they certainly do not prove, this assertion. As the statute under review reveals, the North Carolina apple industry had sufficient lobbying power to secure protectionist legislation. If the state's apple industry produced apples of equal or higher quality relative to those in Washington State, then they likely could have instead secured legislation making available a grading scheme that mimicked that in Washington. Had they done so, they could have used that scheme to demonstrate that their top grade apples were competitive with the top grade Washington apples, and perhaps superior to alternative apples imported from other states. Instead, they elected to prevent anyone from marketing above USDA grade A, which suggests that in general, they would have been disadvantaged by the availability of a superior grade.

> grades on containers shipped into North Carolina, the regulation presented the Washington apple industry with a marketing problem of potentially nationwide significance. . . . Since the ultimate destination of [the stored apples] is unknown . . . , compliance with North Carolina's unique regulation would have required Washington growers to obliterate the printed labels on containers shipped to North Carolina, thus giving their product a damaged appearance. Alternatively, they could have changed their marketing practices to accommodate the needs of North Carolina, *i.e.,* repack apples to be shipped to North Carolina in containers bearing only the USDA grade, and/or store the estimated portion of the harvest destined for that market in special containers. As a last resort, they could discontinue the use of preprinted containers entirely.[127]

Burger than added that "in the event that a number of other States followed North Carolina's lead, the resultant inability to display the Washington grades could force the Washington growers to abandon the State's expensive inspection and grading system.[128]

In evaluating the North Carolina order, Chief Justice Burger articulated the applicable test as follows: "When discrimination against commerce of the type we have found is demonstrated, the burden falls on the State to justify it both in terms of the local benefits flowing under the statute and the unavailability of alternatives adequate to perserve the local interests at stake."[129] As applied to this case, the Chief Justice rejected the state's argument that the statute was necessary to prevent consumer confusion or marketing fraud,[130] noting that "[s]ince Washington grades are in all cases equal or superior to their USDA counterparts, they could only 'deceive' or 'confuse' a consumer to his benefit, hardly a harmful result."[131] More importantly, Burger observed:

> [I]t appears that nondiscriminatory alternatives to the outright ban of Washington State grades are readily available. For example, North Carolina could effectuate its goal by permitting out-of-state growers to utilize state grades only if they also marked their shipment with the applicable USDA label.[132]

Hunt demonstrates that in cases presenting neutral statutes that burden interstate commerce and that appear to be motivated by economic or protectionist interests, the relevant test is effectively the same as in cases involving facial discrimination and in which the state articulates a legitimate–meaning neither financial nor protectionist–purpose. In both cases, the Court will apply strict scrutiny, requiring that the state articulate a legitimate purpose and defend its choice of means by establishing the absence of a nondiscriminatory alternative. Thus, in both categories, the Court presumes against the constitutionality of the statute and places the burden on the state to overcome the burden. In *Hunt*, this rule seems appropriate given that the statute appears to have been the product of an effort by the North Carolina apple industry to benefit itself at the expense of out-of-state competitors, and also of the in-state apple consumers who would otherwise have benefitted from the additional information and product availability that the

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[127] *Hunt*, 432 U.S. at 338.

[128] *Id.*

[129] *Id.* at 353.

[130] To support this finding, Burger further noted that the statute does not prevent the shipment of closed boxes bearing no grades at all. *Id.* at 351.

[131] *Id.* at 354.

[132] *Id.* at 354. Burger added that "some potential for confusion might persist. However, it is the type of 'confusion' that the national interest in the free flow of goods between the States demands be tolerated." *Id.*

premium for marketing superior grade apples would allow Washington exporters to secure in the North Carolina market. In addition, the North Carolina rule threatened to affect Washington apple marketing not only in North Carolina, but on a nation-wide scale.

While the choice of rule in *Hunt* is relatively clear, its application appears problematic when we compare another case that also involves similar special interest legislation benefitting a narrow class of in-state firms at the expense of both out-of-state competitors and in-state consumers. In *Exxon Corp. v. Governor of Maryland*,[133] Justice Stevens, writing for a majority, sustained against a dormant commerce clause challenge a Maryland statute that prohibited refining companies from owning and operating retail service stations in Maryland. As Stevens noted, the statute grew out of the 1973 oil embargo and resulting petroleum shortage. The Governor commissioned a study in response to the complaints of various independent service stations and the study determined that service stations owned by producers or refiners received preferential treatment during the shortage period.

Critical to Stevens's analysis was the fact that no producers or refiners of oil were located in Maryland, and that only about 5% of service stations in Maryland were producer or refiner owned. Stevens noted that "[s]ince Maryland's entire gasoline supply flows in interstate commerce and since there are no local producers or refiners, . . . claims of disparate treatment between interstate and local commerce would be meritless."[134] Stevens further rejected the argument that because the entire burden of divestiture fell on out-of-state companies and that in-state independents receive a benefit, the statute should be struck down. Stevens concluded that "the Act creates no barriers whatsoever against interstate independent dealers; it does not prohibit the flow of interstate goods, place added costs upon them, or distinguish between in-state and out-of-state companies in the retail market."[135]

One difficulty with Stevens's analysis is that while the statute does not distinguish in-state and out-of-state firms, and does not solely benefit in-state firms,[136] the entire burden of the statute does fall on an easily defined subset of out-of-state firms.[137] To appreciate the dynamics of the statute, we must consider why the commissioned study revealed differential treatment between the producer or refiner owned firms and their independent competitors, whether or not locally owned. Recall that the statute went into effect in response to the 1973 oil embargo. In this period, there was considerable uncertainty as to whether the multi-fold price increase following the1973 oil embargo would be followed up with still further price shocks. As a result, producers and refiners were concerned about the effects of future price increases on their long term supply contracts. To hedge against such increases, a rational pricing strategy would include adding the equivalent of a price insurance premium in long term supply contracts. This price premium would leave independents with the following alternatives: (1) secure a long term supply on less favorable terms, or (2) go to the spot markets, where they could secure the going market price, but subject themselves to unpredictable supply. In contrast, for service stations that the producers

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[133]437 U.S. 110 (1978).

[134]*Id.* at 125.

[135]*Id.* at 126.

[136]Out-of-state firms that are not vertically integrated also benefit from the Maryland law.

[137]While I am holding most economic analysis until the next part, the discussion in this paragraph is necessary to expose the seeming doctrinal inconsistency between *Hunt* and *Exxon*, which the game theoretical model developed in part III is in part intended to explain.

or refiners themselves owned, there would be no need to include a hedge against future price increases. Since the service station's profits inured to the benefit of the parent company, the producers or refiners could immediately pass on the burdens or benefits of any future price shocks, thus providing the equivalent of spot market pricing to their retail service stations, while, at the same time, ensuring a steady supply.[138]

In effect, the *Exxon* case is about the benefits associated with vertical integration in a period in which long term supply contracts require a functional insurance premium to cover against unknown pricing contingencies beyond the supplier's control. So viewed, this case appears structurally similar to *Hunt*. The beneficiaries of the prohibition against refiner owned firms are in-state independent stations, who remove from competition those firms that can receive superior pricing and supply terms due to the ability of the parent companies to pass on actual costs without the need for a price insurance premium, while the losers are out-of-state vertically integrated firms and in-state consumers who lose the benefits that such firms can provide in the marketplace in such a period of price fluctuation uncertainly. And yet, despite these apparent similarities, these two cases–both involving special interest legislation in the form of facially neutral statutes imposing an identifiable burden on commerce–are resolved in opposite fashion. This is among the apparent doctrinal inconsistencies that have been the focus of critics of the dormant commerce clause doctrine,[139] and that the game theoretical model is intended to explain. We will now turn to another group of facially neutral statutes that burden commerce, but that involve instrumentalities rather than the flow of goods.

b Instrumentalities of Commerce Cases

The principal contemporary dormant commerce clause case that we will consider before discussing the various doctrinal exceptions is *Kassel v. Consolidated Freightways Corp.*[140] Before doing so, however, it will be helpful to consider briefly three earlier instrumentality of commerce cases. In *South Carolina Hwy. Dept. v. Barnwell Bros.*,[141] Justice Stone, writing for a majority, upheld a state statute setting forth a maximum truck weight based upon a deferential rational basis test, where the state claimed that the statute promoted highway safety, even though trial evidence demonstrated that axleweight was more closely correlated with highway safety than total truck weight. Stone observed that "few subjects of state regulation are so peculiarly of local concern as is the use of state highways."[142] Stone determined that because it was easier to identify truck weight than axle weight, South Carolina legislators had a rational basis for

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[138]The analysis is a bit more complicated. The price premium would benefit vertically integrated retail service stations provided that there was no actual price shock, at least if the price were fixed, as opposed to being placed on some sort of sliding scale. But if the feared price shock were realized, then the independents would have secured the benefit, at least for the period of the contract, of a lower price than would actually be passed on to the vertically integrated retail service stations. So the analysis suggests that the nature of contracts *following a substantial but isolated* price shock is likely to benefit vertically integrated firms. This characterizes the historical period during which the statute in *Exxon* was enacted and the case itself was decided.

[139]*See, e.g.,* Twyman, *supra* note 15, at 403 ("Thus, Exxon . . . suggests a limited review for discriminatory effects produced by a regulation, a position that is inconsistent with the Court's analysis in Hunt.")

[140]450 U.S. 662 (1981).

[141]303 U.S. 177 (1938).

[142]*Id.* at 187.

selecting their chosen means.

In *Southern Pacific Co. v. Arizona*,[143] Justice Stone abandoned the rational basis test in considering the constitutionality of a state regulation setting forth a maximum train length. The Court determined that the heavily regulated area of trains, unlike highways, is of predominently national concern. Thus, Stone stated:

> The decisive question is whether in the circumstances the total effect of the law as a safety measure in reducing accidents and casualties is so slight or problematic as not to outweigh the national interest in keeping interstate commerce free from interferences which seriously impede it and subject it to local regulation which does not have a uniform effect on the interstate train journey which it interrupts.[144]

Justice Stone struck down the law finding that the alleged safety benefits were outweighed by the burdens the statute imposed on commerce.

Finally, in *Bibb v. Navajo Freight Lines*,[145] Justice Douglas, writing for a majority, struck down an Illinois statute that alone required the use of curved mudflaps, where 45 other states permitted straight mudflaps and one other state, Arkansas, prohibited curved mudflaps. Douglas observed that *Bibb* was "one of those cases–few in number–where local safety measures that are nondiscriminatory place an unconstitutional burden on commerce."[146] The case most obviously appears in tension with *Barnwell Bros.*,[147] given that both the South Carolina total truck weight regulation and the Illinois mudflap requirement impose comparable burdens on commerce.

These cases provide the necessary doctrinal backdrop for the Court's most recent major decision that involves the applicable standard in cases that present challenges to state highway safety regulations based upon the dormant commerce clause. *Kassel* is unusual in that it is a divided opinion in which no majority embraces a single test.[148] While the case does not resolve the choice of test,[149] it provides the foundation for subsequent doctrinal formulations. In addition,

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[143]325 U.S. 761 (1945).

[144]*Id.* at 776.

[145]359 U.S. 520 (1959).

[146]359 U.S. at 529.

[147]*See Bibb*, 359 U.S. at 523 (distinguishing *Barnwell Bros.*).

[148]For an analysis that relies upon a lurking vote cycle in *Kassel* to explore implications for the Supreme Court's case decision making rules, see MAXWELL L. STEARNS, CONSTITUTIONAL PROCESS: A SOCIAL CHOICE ANALYSIS OF SUPREME COURT DECISION MAKING (2000); Stearns, *supra* note 72. For present purposes, *Kassel* is important for its doctrinal implications on the dormant side of the commerce clause, rather than for its implications for Supreme Court decision making.

The case is further unusual in that it involved a challenge to an Iowa statute found to be protectionist based in considerable part upon the Iowa governor's failure to sign into law a bill repealing the statute, rather than based upon the enactment of the statute itself. Because the two opinions consistent with the outcome relied upon this peculiar form of subsequent legislative history as if it were part of the actual legislative history, I will not dwell on this point in the analysis to follow.

[149]For an analysis demonstrating that because the two opinions consistent with the outcome are decided

the game theoretical model developed in part III sheds light on the Supreme Court's division in this group of cases on which test to apply.[150]

An Iowa statute prohibited the use of 65-foot twin trailers, and contained a series of exceptions benefitting only Iowa residents. Specifically, the statute allowed such trailers to make deliveries from out of state to border cities[151]; to make deliveries from point to point within the state; and to allow Iowa truck manufacturers to ship trucks up to 70 feet in length. Otherwise, such trailers were prohibited, even though they were permitted in all states that surrounded Iowa. As Justice Rehnquist observed in dissent, while the states surrounding Iowa allowed 65 foot twin trailers, the states in the Northeast and Southwest corridors and in the District of Columbia, like Iowa, prohibited them.[152] Consolidated challenged the statute, which required it to limit its shipments through Iowa to 55 foot singles or 60-foot doubles, to detach 65-foot doubles and take each through the state separately, or to divert 65-foot doubles around the state. The state defended the statute, claiming that 65-foot twins are more dangerous than 55-foot singles and that the law promotes safety and reduces wear and tear on the state highways by diverting truck traffic out of state. The federal district court employed the balancing test previously articulated in *Raymond Motor Transportation, Inc. v. Rice*,[153] under which the Court "weigh[ed] . . . the asserted safety purpose against the degree of interference with interstate commerce."[154] Applying that test, the district cout rejected the safety rationale on the ground that the prohibited 65-foot twins were no less safe than permitted 55-foot singles.

On appeal, the Supreme Court fractured. Justice Powell, writing for a plurality of four, struck down the statute. Justice Brennan, writing for two, concurred in the judgment. Then-Associate Justice Rehnquist, writing for three, dissented. Justice Powell began by observing that the mere incantation of a highway safety benefit was insufficient to preclude independent balancing under the *Raymond* test. Powell noted that the appropriate "weighing" requires "a sensitive consideration of the weight and nature of the state regulatory concern in light of the extent of the burden imposed on the course of interstate trade."[155] Applying this test, Powell found that "the Iowa truck-length limitations unconstitutionally burden interstate commerce."[156] After going through, and refuting, the state's claimed safety justifications, Powell noted that the

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along different analytical dimensions, the narrowest grounds rule does not apply, see STEARNS, *supra* note 145, at 99-102.

[150]*See infra* part IV.B.2.a.

[151]The state enacted the border cities exception, and the Governor signed it into law, after vetoing the repeal bill.

[152]*Kassel*, 450 U.S. at 688 (Rehnquist, J., dissenting).

[153]434 U.S. 429 (1978).

[154]*Id.* at 443.

[155]*Id.* at 670.

[156]*Id.* at 671.

"special deference" normally accorded state highway safety regulations "derives in part from the assumption that where such regulations do not discriminate on their face against interstate commerce, their burden usually falls on local economic interests as well as other States' economic interests, thus insuring that the State's own political processes will serve as a check against unduly burdensome regulation."[157] Here, Powell determined, less deference is appropriate because the statutory regulation "bears disproportionately on out-of-state residents and businesses."[158]

Powell then reviewed the history of a 1974 bill that would have repealed the 65-foot twin restriction. In vetoing the bill, Governor Ray had stated:

> I find sympathy with those who are doing business in our state and whose enterprises could gain from increased cargo carrying ability by trucks. However, with this bill, the Legislature has pursued a course that would benefit only a few Iowa-based companies while providing a great advantage for out-of-state trucking firms and competitors at the expense of our Iowa citizens.[159]

Powell observed:

> It is far from clear that Iowa was motivated primarily by a judgment that 65-foot doubles are less safe than 55-foot singles. Rather, Iowa seems to have hoped to limit the use of its highways by deflecting some through traffic. . . . [A] State cannot constitutionally promote its own parochial interests by requiring safe vehicles to detour around it.[160]

After considering the evidence in support of the safety justification introduced at trial, Powell concluded "because Iowa has imposed this burden without any significant countervailing safety interest, its statute violates the Commerce Clause."[161] Powell voted to strike down the law using a balancing test after considering and rejecting the proferred safety benefits.

Justice Brennan, concurring in the judgment, rejected the balancing test in the context of highway safety in favor of a test that inquired whether the Iowa legislature had a rational justification in support of the law at the time that the statute was enacted. Brennan objected to the reliance in both the opinions of Justice Powell for a plurality, and Justice Rehnquist in dissent, on evidence in support of safety justifications offered initially at trial.[162] In addition, while at various points, he spoke in terms of a balancing inquiry, Brennan made clear that his preferred test was rational basis. Thus, Brennan asserted: "It is not the function of the court to decide

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[157]*Id.* at 675.

[158]*Id.* at 676.

[159]*Id.* at 677.

[160]*Id.* at 678.

[161]*Id.* at 678-79.

[162]Thus, Brennan stated: "Both the opinion of my Brother Powell and the opinion of my Brother Rehnquist are predicated upon the supposition that the constitutionality of a state regulation is determined by the factual record created by the State's own lawyers in trial court." *Kassel*, 450 U.S. at 680 (Brennan, J., concurring in the judgment). Instead, Brennan asserted that "a court should focus ultimately on the regulatory purposes identified by the lawmakers and on the evidence before or available to them that might have supported their judgment." *Id.*

whether *in fact* the regulation promotes its intended purpose, so long as an examination of the evidence before or available to the lawmaker indicates that the regulation is not wholly irrational in light of its purposes."[163] Reviewing the contemporaneous evidence, Brennan determined that it evinced a pure protectionist motive, and thus subjected the state's law to "a virtually per se rule of invalidity."[164]

Finally, Justice Rehnquist, writing in dissent, highlighted the anomaly in the Court's opinions. Like Justice Brennan, Rehnquist rejected Powell's application of the balancing test. Other than to determine whether the stated rationale is a pretext for an illicit protectionist purpose, Rehnquist asserted:

> It is emphatically not our task to balance the incremental safety benefits from prohibiting 65-foot doubles as opposed to 60-foot doubles against the burden on commerce.
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> The question is rather whether it can be said that the benefits flowing to Iowa from a rational truck-length limitation are "slight or problematical." . . . The particular line chosen by Iowa–60 feet–is relevant only to the question whether the limit is a rational one.[165]

While Rehnquist agreed with Brennan that other than to identify an illicit pretext, the only relevant inquiry was whether the law had a rational basis, he agreed with Powell that it was proper to consider evidence introduced by the state's lawyers at trial. Thus, Rehnquist stated: "Justice Brennan can cite no authority for the proposition that possible legislative purposes suggested by a State's lawyers should not be considered in Commerce Clause cases."[166] He further observed that "As I read the various opinions in this case, . . . only four Justices invalidate Iowa's law on the basis of the analysis in *Raymond*."[167] While Rehnquist agreed that the *Raymond* test applied, based upon his review of the trial evidence, he determined that the law did rationally further a legitimate safety interest, and thus voted to sustain the statute. The analysis demonstrates that while the Court generally agrees that something less than strict scrutiny is appropriate in this context, it is unable to agree on whether the relevant test is rational basis or the somewhat more stringent balancing test.[168]

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[163] *Id.* at 680 (Brennan, J., concurring in the judgment).

[164] *Id.* at 686.

[165] *Id.* at 697-98 (Rehnquist, J., dissenting).

[166] *Id.* at 702.

[167] *Id.* at 700 n.10.

[168] I have previously demonstrated that this case reveals a collective preference aggregation problem. *See* STEARNS, *supra* note 145, at 99-102. To explain the anomaly, it is important to articulate a premise that is fully consistent with the analyses in all three opinions: If the Court determines that the appropriate test is rational basis and if it applies the more liberal evidentiary rule, thus considering evidence in support of the chosen test introduced initially by the state's trial lawyers, then it should reject the dormant commerce clause challenge to the Iowa statute. Based upon this assumption, we can identify a logical voting progression supporting the dissenting result. One majority favors the rational basis test (the Brennan plus Rehnquist camps for a total of 5). A second majority favors

The following flow chart summarizes the Court's dormant commerce clause analysis presented thus far:

Table 3: Dormant Commerce Clause Flow Chart

	Category	Rule	Illustrations/Cases
Facially Discriminatory	**1. Protectionist/- Economic motive**	**Per se rule of invalidity**	**Traditional Tarriffs/Embargoes**
	2. Non-economic motivation	**Strict scrutiny with burden on state (requiring legitimate state interest and absence of non-discriminatory alternative)**	**Environmental Protection Statutes; e.g., City of Philadelphia v. NJ; Maine v. Taylor; Sporhase v. Nebraska; A&P Tea Co. v. Cotrell**
Facially Neutral	**3. Protectionist/- Economic motive**	**Strict Scrutiny (same test as in category #2)**	**Hunt v. Washington; But see Exxon v. MD**
	4. Legitimate Interest with Incidental Burden on Commerce	**Balancing test with**	**Raymond v. Rice; Bibb v. Navajo Freight Lines; Kassel v. Consolidated Freightways**

Table 3 summarizes the doctrinal discussion of the dormant commerce clause cases. While some case placements required extrapolations, set out in the prior discussion, from the Court's imprecise (e.g., City of Philadelphia, Sporhase) or conflicting (e.g., Kassel) doctrinal analyses, I based the vast majority of case categorizations entirely upon the Court's own doctrinal formulations. The table is ultimately the starting point in our analysis, as the next group of cases will show. In fact, the point of presenting this table now is to use it as a basis of comparison for the case categories in which the Court has exempted the challenged statutes from dormant commerce clause scrutiny.

Surprisingly, perhaps, given the per se rule of invalidity, the principal exception to the dormant commerce clause is the market participant doctrine, which appears to meet all of the criteria for category 1. In fact, as we will see in the next subpart, the market participant doctrine removes entirely the relevant cases from presumptive invalidity under the dormant commerce

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admitting newly introduced evidence to determine if the chosen test is met (the Powell plus Rehnquist camps for a total of 7). And yet, the controlling majority votes to strike down the Iowa statute (the Powell plus Brennan camps for a total of 6). Justice Rehnquist apparently recognized this anomaly. After noting that no one supported Brennan's insistence upon contemporaneous legislative justifications for the Iowa statute, he further observed: "It should not escape notice that a majority of this Court goes on record today as agreeing that courts in commerce clause cases do not sit and weigh safety benefits against burdens on commerce when the safety benefits are not illusory." *Kassel*, 450 U.S. at 697 (Rehnquist, J., dissenting). The majority he had in mind, of course, was the Brennan plus Rehnquist camps. In spite of this anomaly, the general consensus is that the applicable test is some form of balancing, albeit one that is more deferential than strict scrutiny, at least absent some clear evidence of pretext.

clause doctrine notwithstanding facial discrimination and a clear discriminatory or economic purpose. Similarly, the export taxation doctrine removes statutes from strict scrutiny under category 3 notwithstanding a clear intent to benefit the state economically at the expense of out-of-state purchasers of the exported good. And finally, we will consider the Article IV privileges and immunities doctrine, which effectively restores a kind of scrutiny similar to that employed in cases falling into category 2, even though the case appears to satisfy the requirements of the market participant doctrine. The inconsistencies revealed thus far only scratch the surface.

3. The Market Participant Exception to the Dormant Commerce Clause[169]

I will now describe the four principal market participant cases. In three cases, the Court created an exemption from ordinary dormant commerce clause scrutiny. In the most recent case in this grouping, the Court declined to apply the market participant exception, thus reinstating dormant commerce clause scrutiny. The most recent of these four decisions, *South-Central Timber Development v. Wunnicke*,[170] summarized and distinguished the other three in a successful effort to bypass the market participant exception to the dormant commerce clause. In doing so, the *Wunnicke* Court applied the dormant commerce clause doctrine to strike down the State of Alaska's inclusion of an in-state processing requirement in a contract for the sale of 49 million board of timber with a Japanese buyer. Without the benefit of the market participant exception, the case would have fallen squarely into category 1 of the Court's dormant commerce clause jurisprudence, given the facial discrimination and the economic motive underlying the in-state processing requirement. Without the market participant exception, the per se rule of invalidity would have applied.[171] The issue in *Wunnicke* was whether the state, acting as an entrepreneur rather than as a regulator, could not only select with whom it would deal, but also could establish its own terms of contracting without dormant commerce clause scrutiny. To support its argument that the market participant doctrine, rather the dormant commerce clause, applied, the state relied upon the following three market participation cases.

In the first case, *Hughes v. Alexandria Scrap Corp.*,[172] an out-of-state processor of junked cars challenged a scheme in the State of Maryland designed to reduce the number of junked cars in the state. The Maryland legislature had established a "bounty" for cars that bore a Maryland license plate, and imposed more stringent documentation requirements on out-of-state scrap processors than on in-state processors. An out-of-state processor challenged the program, which facially discriminated in commerce, claiming that it violated the dormant commerce clause. The *Hughes* Court rejected the challenge on the ground that the state was acting in an entrepreneurial, rather than regulatory, capacity. Thus, the Court stated: "[n]othing in the purposes animating the

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[169]Portions of the discussion in this subpart are based upon Maxwell L. Stearns, *A Private-Rights Standing Model to Promote Public-Regarding Behavior by Government-Owned Corporations* (forthcoming as book chapter on Government-Owned Corporations, Kluwer Press 2003).

[170]467 U.S. 82 (1984).

[171]*See id.* at 100.

[172]426 U.S. 794 (1976).

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."[173]

In the second case, *Reeves, Inc. v. Stake*,[174] the Court rejected a dormant commerce clause challenge to a South Dakota law that restricted the sale of cement from a state-owned plant to state residents. The *Reeves* Court stated: "the basic distinction drawn in *Alexandria Scrap* between States as market participants and States as market regulators makes good sense and sound law."[175] The Court then acknowledged "the long recognized right of trader or manufacturer, engaged in an entirely private business freely to exercise his own independent discretion as to parties with whom he will deal."[176] In describing this case, the *Wunnicke* Court stated: "In essence, the [*Reeves*] Court recognized the principle that the Commerce Clause [in it dormant capacity] places no limitations on a State's refusal to deal with particular parties when it is participating in the interstate market for goods."[177]

Finally, in *White v. Massachusetts Council of Construction Employers, Inc.,*[178] the Supreme Court rejected a dormant commerce clause challenge to an executive order issued by the Mayor of Boston that required all city funded construction projects to be performed by a work force with at least 50% Boston residents. As the Court acknowledged, the critical difference between *White* on the one hand, and *Hughes* and *Reeves* on the other, was that in *White*, the Mayor of Boston had demanded that a provision be included in contracts to which the city was not in privity. Specifically, the city required its contractors to demand that their subcontractors ensure a minimum 50% in-city employment. The *White* Court nonetheless sustained the municipal employment requirement, applying the market participant doctrine. The Court stated that while there were undoubtedly some limits on the power of a state or local government to impose restrictions beyond the immediate parties to a contract, it was not necessary to determine what those limits were in the present case. The Court relied upon what it deemed a "crucial fact" that "[e]veryone affected by the order [was], in a substantial if informal sense, 'working for the city.'"[179]

The *White* case is particularly interesting for two reasons. First, on its facts it was the closest to *Wunnicke* in that it imposed a restriction on a downstream transaction to which the state would not be a party. Second, as shown below,[180] it is in virtually all respects factually

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[173]*Id.* at 810.

[174]447 U.S. 429 (1980).

[175]447 U.S. at 436.

[176]*Id.* at 438.

[177]467 U.S. at 94.

[178]460 U.S. 204 (1983).

[179]*Id.* at 210 n.7.

[180]*See infra* part II.C.4.

identical to a case decided just one year later that appears to have produced a seemingly opposite result in the form of a remand under the Article IV privileges and immunities clause.

It was against the backdrop of these three market participant cases that the divided *Wunnicke* Court considered whether to apply the dormant commerce clause doctrine or the market participant exception to Alaska's in-state processing requirement. As stated above, because the contract provision was facially discriminatory and economically motivated, it was certain that under the dormant commerce clause the provision would fail. The *Wunnicke* plurality set about distinguishing the three prior market participant cases, thus holding the provision invalid under the dormant commerce clause. The plurality distinguished *Alexandria Scrap* on the ground that that case involved the direct purchase of goods, without the state imposing any downstream, or out-of-privity, requirements. The plurality distinguished *Reeves* on the same basis, stating that the right to choose with whom the state deals did not include the right to impose conditions downstream. The plurality also noted that dormant commerce clause scrutiny might be more appropriate in *Wunnicke,* which involved the sale of a natural resource, than in *Reeves*, which involved the sale of cement, a complex manufactured good.[181] As stated above, the more difficult case was *White*, which did involve an out-of-privity restriction. The *Wunnicke* plurality held that while *White* allowed the imposition of such a provision, it did so in the relevant market in which the city was operating.[182] Applying antitrust principles, the Court added: "Unless the 'market' is relatively narrowly defined, the doctrine has the potential of swallowing up the rule that States may not impose substantial burdens on interstate commerce even if they act with the permissible state purpose of fostering local industry."[183]

As then-Associate Justice observed in dissent, the *Wunnicke* plurality's economic analysis appears to have provided the timber purchaser a windfall, at least if we assume, as seems reasonable, that the contract price capitalized the in-state processing requirement. For present purposes, the more important point is to recognize the seeming incongruity that these cases pose for the dormant commerce clause doctrine. In each case, the Court has exempted the state from ordinary dormant commerce clause scrutiny, effectively giving the state a pass in the very case category in which it has insisted that a virtual per se rule of invalidity applies. And while the stated rationale–that the state is acting in an entrepreneurial rather than regulatory capacity–provides a doctrinal basis for distinction, it is not grounded in an obvious policy justification for giving the state preferential treatment. In fact, the incentives that the doctrine creates might well be perverse. If the state, when acting in an entrepreneurial capacity, is supposed to mimic private market actors, then the doctrine has the effect of allowing the state to select with whom it deals without the competitive pressures that discipline private firms making

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[181]The Court added that close scrutiny might also be more appropriate when dealing with foreign purchasers.

[182]Recall Justice Rehnquist's assertion in *White* that everyone was, at least in an informal sense, working for the city.

[183]*Wunnicke*, 467 U.S. at 97-98.

such choices under market conditions.[184] And the doctrinal anomaly only deepens when the consider the next case, in which on virtually identical facts, the Court identifies another constitutional clause upon which to rest its decision to remove the case from the lax scrutiny of the market participant doctrine, effectively restoring a level of scrutiny closer to that arising under the dormant commerce clause.

4. Article IV Privileges and Immunities

In a case that appears to create a tension with its market participant doctrine, the Supreme Court reversed and remanded a decision declining to apply the Article IV privileges and immunities clause to a challenged municipal ordinance that was in all relevant respects identical to the one sustained against dormant commerce clause scrutiny in *White*. In *United Building & Construction Trades Council v. Camden*,[185] the Court considered the constitutionality of an ordinance enacted by the City of Camden, New Jersey that required the city's contractors to ensure a minimum of 40% city employees in their contracts and their subcontractors' contracts for all city contracts. The New Jersey Supreme Court had rejected a dormant commerce clause challenge on the ground that the state was acting as a market participant, and further rejected a challenge under the Article IV privileges and immunities clause, holding that the clause applied only to state legislation, and not to municipal ordinances.[186]

Writing for a majority, Justice Rehnquist held that under the circumstances of the case, the Article IV privileges and immunities clause does apply, and remanded for further proceedings to determine if the two part test–whether municipal employment is fundamental and whether out of state employment is a peculiar source of the problem that the ordinance seeks to remedy[187]–was met. In addition to the obvious tension with the then-recent ruling in *White*, the *Camden* ruling was unusual in that prior to Camden, it was not obvious that Article IV privileges

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[184]For a recent paper in which I explore this theme in greater depth, see Stearns, *supra* note 166; *see also* Wells and Hellerstein, *The Governmental-Proprietary Distinction in Constitutional Law*, 66 VA. L. REV. 1073 (1980) (describing different incentives confronting private firms and state actors operating as entrepreneurs). The doctrinal incentives becomes all the more perverse when we consider the two recent decisions, College Savings Bank v. Florida Prepaid Post Secondary Education Expense Board, 527 U.S. 666 (1999), and Florida Prepaid Post Secondary Education Expense Board v. College Savings Bank, 527 U.S. 627 (1999). In those cases, the Court rejected a market participant analysis offered to deny an arm of the State of Florida the benefit of sovereign immunity when appellant, a private New Jersey bank, alleged that the state had infringed upon its patent and misled consumers with respect to its competitive college savings annuity plan. If the Court is going to provide the state the benefits of selecting with whom to deal and on what terms under the market participant doctrine, even though the state is not subject to private sector competitive pressures in making its decisions, then one could argue that the Court should at least be consistent and hold the state to the same legal obligations as its private competitors when the state puts on an entrepreneurial mantle.

[185]465 U.S. 208 (1984)

[186]Article IV states: "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens of the Several States." U.S. CONST. ART. IV, § 2, cl.1. As stated previously, *see supra* note 29, Article IV privileges and immunities does not apply to corporations. *See* Paul v. Virginia, 75 U.S. (8 Wall.) 168 (1868).

[187]*Camden*, 465 U.S. at 221-22.

and immunities applied at all to municipal ordinances that discriminated against all nonresidents, as distinguished from state statutes that discriminated against out-of-state citizens.[188] The challenged ordinance instead was passed by a city and seemed to discriminate equally against New Jersey citizens who resided outside Camden. Justice Rehnquist reasoned that because the Camden ordinance was enacted pursuant to a state-wide scheme that allowed individual municipalities within New Jersey to enact municipal employment preferences for construction work, thus ultimately benefitting the state's residents as a whole, the Article IV privileges and immunities clause applied. Otherwise, in theory, a state could pass a statute dividing itself into two units and then allow each subdivision to discriminate against citizens of the state that reside in the other subdivision in addition to discriminating against citizens of other states, thus producing an end run around the Article IV privileges or immunities clause.[189] Before returning to, and revising, Table 3, we have one more case, creating one more exception to the dormant commerce clause doctrine, to consider.

5. The Export Taxation Doctrine

In *Commonwealth Edison Co. v. Montana*,[190] the Court, per Justice Stevens, addressed a challenge to a Montana statute that applied a 30% tax on the contract price for the severance of coal–substantially higher than that in most other states–when 90% of Montana coal was shipped out of state. Montana holds 25% of the nation's coal reserves and over 50% of the nation's low sulpher coal reserves. The tax produced 20% of the state's tax revenues. While the case met the criteria for category 3, namely a facially neutral law that was economically motivated, thus appearing to subject it to strict scrutiny, the Court instead applied a four-part test that effectively translated to a form of rational basis scrutiny. Under the text, the tax must (1) be applied to an activity with a substantial nexus to the state; (2) be fairly apportioned; (3) not discriminate in interstate commerce; and (4) be fairly related to services provided by the state.[191] The fair apportionment requirement provides the state considerably broader discretion than does the strict scrutiny rule in category 3 dormant commerce clause cases.

The Court rejected the dormant commerce clause challenge, stating that it was wrongly premised upon the assumption that out-of-state purchasers of a scarce resource are entitled to a reasonable price regardless of the price paid by in-state purchasers. Had the Court instead

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[188]In *Camden*, Justice Rehnquist rejected this distinction on the grounds that the municipal ordinance itself was facilitated by a state statute that allowed municipalities to enact such preferences and that municipalities are political subdivisions of states. 465 U.S. at 214-15.

[189]For a case arising under the dormant commerce clause that also turns on preventing the states from employing a divide-and-conquer strategy, see Fort Gratiot Sanitary Landfill Inc. v. Michigan Department of Natural Resources, 504 U.S. 353, 361 (1992) (striking down Michigan statute barring private landfills from accepting solid waste from outside the county in which they are located and stating that "a State (or one of its political subdivisions) may not avoid the strictures of the Commerce Clause by curtailing the movement of articles of commerce through subdivisions of the State, rather than through the State itself.").

[190]453 U.S. 609 (1981).

[191]*Id.* at 617.

applied the tax and rebate analysis in *C & A Carbone*, and considered that 20% of the state's tax revenues derive from the coal export, then it would have recognized that those paying more for coal are likely compensated for this burden through the corresponding reduction in their tax burdens. This is especially likely if we assume, as seems reasonable, that the actual purchasers are able to pass on the additional costs to a dispersed group of in-state consumers.[192] So viewed, the case appears in tension with Justice Stevens's own analysis thirteen years earlier in *West Lynn Creamery*.[193]

We are now ready to reconsider the basic doctrinal framework set out in Table 3, this time including the additional inconsistencies from the three associated doctrines described above.

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[192]In other words, it seems plausible to assume that the demand over the relevant range was likely inelastic, thus ensuring that the incidence of the tax was not borne by the initial purchaser, but rather was spread to dispersed end purchasers. If this is correct, the incentives of those who initially bore the tax to invest in opposing it are substantially diminished, if not altogether removed.

[193]512 U.S. 186 (1994).

Table 4: Dormant Commerce Clause and Related Doctrines: Inconsistencies Exposed

Category	Rule	Illustrative Cases and Doctrines	Problem Cases and Doctrines or Other Difficulties
1. Facially Disc.: Protectionist/Economicmotive	**Per se rule of invalidity**	**Traditional Tarriffs/Embargoes; Sporhase; A&P**	**Market participant doctrine: Hughes, Reeves, White.** ***But see*** **Wunnicke, City of Camden**
2. Facially Disc.: Non-economic motivation	**Strict scrutiny with burden on state (requiring legitimate state interest and absence of non-discriminatory alternative)**	**Environmental Protection Statutes, e.g., City of Philadelphia v. NJ**	**Perverse incentives in Waste Disposal Cases; Maine v. Taylor; Sporhase v. Nebraska; United Building & Constr'n Trades Council v. Camden**
3. Facially Neutral: Protectionist/Economic motive	**Strict Scrutiny (see category #2)**	**Hunt v. Washington; But see Exxon v. MD**	**Export Taxation Doctrine; Commonwealth Edison v. Montana**
4. Facially Neutral: Legitimate Interest with Incidental Burden	**Balancing test with burden on challenger (weighs claimed benefits of law against alleged burdens on commerce)**	**Raymond v. Rice; Bibb v. Navajo Freight Lines; Kassel v. Consolidated Freightways**	**Lack of certainty concerning application of balancing test or rational basis scrutiny**

Table 4 reveals a number of inconsistencies running through the four principal doctrinal categories under consideration: the dormant commerce clause; the market participant doctrine;

the Article IV privileges and immunities clause; and the export taxation doctrine. Let us now consider the exposed anomalies by category.

Category 1: In this case category, the Court appears to have provided the clearest guidance, applying the per se rule of invalidity to facially discriminatory statutes that have an obvious protectionist or economic motive. And yet, the Court has carved out a major exception that applies when the state operates in an entrepreneurial, rather than regulatory, capacity. The market participant exception applies notwithstanding facially discriminatory means and an obvious economic motive. Rather than applying the per se rule of invalidity, the Court effectively gives a free pass to discriminate in commerce. Moreover, the Court has created an exception to the exception itself, and has done so based upon dubious factual distinctions (whether the out-of-privity transaction that the state seeks to regulate is outside the relevant market), or when the Court invokes the alternative textual hook of Article IV privileges and immunities.

Category 2: The Court applies strict scrutiny in evaluating facially discriminatory statutes when the state articulates a nonprotectionist, noneconomically motivated, purpose. In this category we have seen the Court strike down a restriction on waste imports even though the effect of the ruling appears likely to have reduced the provision of waste disposal services, whether accepting waste in state or from interstate commerce, by encouraging the state to refuse necessary permits, or even to shut down existing facilities. In addition, while the Court applies strict scrutiny, *Maine v. Taylor* reveals that the test is not necessarily fatal. Finally, *Sporhase* reveals that the Court has created a rule of thumb against reciprocity agreements, when in fact, such agreements are likely the least restrictive means of promoting free trade among competitor states.

Category 3: The Court applies strict scrutiny to facially neutral laws that evince a protectionist or economically motivated purpose. While the application of this test is usually fatal, the Court produced a seemingly inconsistent result in *Exxon v. Maryland* based upon a questionable economic analysis. And in *Commonwealth Edison v. Montana*, the Court carved out an exception, similar to that arising under the market participant doctrine in category 1, when the state structures its burdensome law in the form of an export tax. As stated previously, this doctrine appears further in tension with *West Lynn Creamery* from Category 2.

Category 4: In this final category, we have seen a division within the Court concerning the appropriate test to apply. The division is of sufficient magnitude that in the most recent principal case to address the issue, the Court was so closely divided that the case appears to have produced an unstable doctrinal–or cyclical–result.

The game theoretical model cannot eliminate every one of these doctrinal anomalies or eliminate every apparent inconsistency within the relevant cases. But I hope to show that it is capable of explaining most of them, and most importantly, that it manages to do so by including, rather than excluding, the major doctrinal exceptions to the dormant commerce clause, which have plagued traditional doctrinal analysis. And more importantly, the analysis provides a sound normative foundation for these much criticized doctrines and case results. Unlike most studies of the clause which consider one doctrine, or one category of cases within a given doctrine, the model presented in the next part cuts across all four doctrines that I have described. In the next part, I will set out the game theoretical model, and in the part that follows, I will explain its power in making sense of these much contested doctrines.

III. A Game Theoretical Model of the Dormant Commerce Clause

All:	*RENT RENT RENT RENT RENT*
	WE'RE NOT GONNA PAY RENT
Roger and Mark:	*'CAUSE EVERYTHING IS RENT*[194]

A superficial reading of public choice literature might suggest a picture not unlike the refrain in the song "Rent" from Jonathan Larson's 1996 Tony Award and Pulitzer Prize winning musical of the same name. The public choice caricature presents all legislative activity as a self-interested pursuit in which "everything is rent," and recommends that the judiciary, which we are to assume–like the chorus–represents our collective interests, somehow ensure that "we're not gonna pay."

The analysis to follow rests not only on game theory, but also on an understanding of "rents" and "rent seeking." While the latter terms are more closely associated with public choice, rents and rent seeking are highly relevant to the analysis of the dormant commerce clause because as the game theoretical analysis reveals, states can and do play cooperative and noncooperative games concerning various forms of rent. In the analysis developed below, however, the caricature of legislative behavior in which everything is rent–and that all pursuits of rent are illicit–serves as a point of departure. The critical inquiry is not whether legislatures are prone to rent seeking (they are), or whether legislative rent seeking is good or bad (it's both). Instead, critical inquiry is how the federal judiciary furthers its legitimate role in a scheme of separation of powers by curbing particular manifestations of rent seeking that are of concern to the dormant commerce clause doctrine, while, at the same time, allowing state legislatures to pursue, subject only to state law constraints or other independent constitutional checks, other forms of legislative behavior that can also credibly be characterized as the product of rent seeking.

This article will show that the dormant commerce clause doctrine, properly understood, does not target state law rent seeking as such, but rather targets two particular types of state rent seeking laws. First, it targets those laws that, if sustained, would likely encourage other states to pursue similar harmful rents. The end result of such a prisoners' dilemma game would be a regime of mutual defection. As a general matter, even those who are generally critical of the dormant commerce clause doctrine, accept these case results.[195] Second, in a more controversial group of cases, the doctrine targets state laws that undermine other states in their efforts to

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[194] Jonathan Larson, *Rent*, RENT (1996).

[195] *See* Denning and Reynolds, *supra* note 12. Thus, the authors observe:

> Even Justice Scalia, who dissented in Camps Newfound, and who has been a vociferous critic of the Court's dormant Commerce Clause jurisprudence, has accepted the doctrine insofar as it prohibits states from facially discriminating against interstate commerce or enacting protectionist legislation designed to benefit local producers at the expense of out-of-state commercial enterprises.

Id. at 1112.

pursue cooperative, pro-commerce strategies in a multiple Nash equilibrium game. This occurs when a group of states, through tacit coordination, adopts a common regime from among two or more available Nash equilibrium strategies, with the benign effect of reducing the impediments to interstate commerce. When an individual state enacts a law that has the effect of undermining such a benign scheme, it has the effect of appropriating quasi rents that would not have became but for the pro-commerce, Nash equilibrium strategy selected by the adversely affected states.

In this part, I will define and illustrate the necessary concepts to develop the game theoretical model of the dormant commerce clause doctrine. In the part that follows, I will apply that model to the cases and doctrine introduced in Part II. To place the two dominant games–the prisoners' dilemma and the multiple Nash equilibrium game–in their appropriate context, it is important to define and illustrate several related economic concepts. This will also help to get past the superficial assertion that "everything is rent" by allowing us to distinguish benign from illicit rents, and further to distinguish among those rents that are illicit, those that are within and without the proper reach of the dormant commerce clause. The analysis begins with a definition of "rent" and the various specialized forms of rent, including economic rents, legislative rents,[196] Ricardian rents, and finally appropriable quasi rents. In addition, I will consider the closely related–and sometimes overlapping–concepts of transactions costs, bilateral monopoly, and empty core bargaining (or cycling). I will first present an overview of the game theoretical model, and then provide a more detailed exposition in which I will define and illustrate each of these terms. After developing the game theoretical model in the remainder of this part, which includes the prisoners' dilemma and the multiple Nash equilibrium games, in part IV, I will reevaluate the cases and doctrines discussed in part II. The analysis will show that analyzing the cases and doctrines according to whether they are the likely product of efforts to secure rents that invite retaliation and thus mutual defection, or that involve efforts to secure appropriable quasi rents in a manner that undermines other states in their efforts to adopt benign Nash equilibrium strategies that facilitate the flow of commerce, provides both a positive explanation and a sound normative foundation for, the Court's dormant commerce clause and related doctrines.

A. A Brief Overview of the Model

Without disputing that many if not most of the cases discussed in Part II possess features that can properly be characterized as furthering some aspect of the public good, as a general matter it is not an outstanding theoretical accomplishment to identify the desire to secure some form of rent as the probable motive for securing the statutes subject to dormant commerce clause scrutiny in these cases.[197] To illustrate, consider just a few of the more obvious cases. In *Hunt*,

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[196]The economic foundation for legislative rent seeking is most commonly associated with the seminal work by Gordon Tullock, *The Welfare Costs of Tarriffs, Monopolies and Theft,* 32 WESTERN ECON. J. 5 (1967).

[197]Professors Martin H. Redish and Kirk J. Kaludis have offered a similar observation about the relationship between the assumptions of interest group theory and underlying legislative motivations:

> While public choice theory's extreme characterization of the legislative process appears to have little empirical support, it would be naive to doubt the impact of interest groups and other questionable influences on the legislative process. Although legislatures will generally characterize their actions in public interest terms, in reality their motives often focus more on advancement of one interest group at the expense of competing groups.

the North Carolina apple producers sought to secure a rent in the form of additional profits that would result from effectively downgrading superior out-of-state competitive apples at the expense in-state apple purchasers, who would benefit from the additional information and the superior quality applies that the Washington supplemental grading system would have provided, and of the Washington apple industry. In *Exxon*, the Maryland independent service stations secured a rent in the form of additional profit that would result from removing competitors who, as a result of market conditions favoring vertically integrated retail service outlets in the relevant historical period, were able to secure more favorable price and supply terms, at the expense of in-state consumers who would benefit from this form of competition, and of the owners of the competitive retail gas outlets. And in *White*, prospective municipal employees of city contractors secured a rent in the form of more favorable wages or opportunities for employment that would result from limiting the eligible labor pool for half of the contractor and subcontractor slots for construction jobs on behalf of the city at the expense of taxpayers who would offset the additional costs in terms of higher taxes and of other potential workers who did not reside in Boston. While each of these cases–and virtually all of the others described in part II–can comfortably be characterized in rent seeking terms, the results, and the doctrines that emerge from the cases, have been much criticized as inconsistent.

While I will begin with the premise that virtually all state legislation that has been challenged as a violation of the dormant commerce can be reasonably be understood in terms of rent seeking, this premise does not contradict my earlier assertion that the underlying legislation in each case is also susceptible of a competing public goods characterization. Rather, I am asserting that *even if* we begin our analysis by imposing a common–and negative–rent seeking story on each set of underlying set of case facts, the game theoretical model developed in this article provides a positive account of why the Supreme Court has elected to countenance some rent seeking statutes, while prohibiting others. More importantly, perhaps, in identifying the most likely rent seeking explanation of each challenged statute, I will avoid the inherent danger of employing a post-hoc classification method of looking more optimistically after the fact for the public good in those laws that Supreme Court has sustained, while scrutinizing with a more jaundiced eye those statutes that the Court has struck down. Employing a consistent method of classifying the underlying case facts thus facilitates a sharper focus in analyzing the various manifestations of state law rent seeking that underlie the challenged statutes. Doing so will further allow us to determine whether there exists a meaningful pattern in those cases in which the Court sustains, and those cases in which the Court strikes down, challenged state laws that allegedly infringe on commerce.

While it is not difficult to characterize each challenged law as the product of rent seeking, the game theoretical model reveals that not all rents are created equal from the standpoint of the dormant commerce clause doctrine. Simply put, the dormant commerce clause is concerned with some manifestations of rent seeking, and is indifferent to others. And to be clear, I will not import intuitions about public good versus rent seeking through the back door. I will not suggest, for example, that those forms of rent seeking that are beyond the purview of dormant commerce clause scrutiny are somehow more benign than those that are of particular concern to the

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Martin H. Redish and Kirk J. Kaludis, *The Right of Expressive Access in First Amendment Theory: Redistributive Values and the Democratic Dilemna,* 93 NW. L REV. 1003, 1109-10 (1999).

commerce clause. Indeed, some manifestation of state-law rent seeking, which the Court sustains against a dormant commerce clause challenge, impose costs that are as great as or greater than those which the Court has struck down. But because it is the nature of the rent, and not the magnitude of the cost that the rent imposes, that determines whether to apply the dormant commerce clause, the game theoretical model proves essential in distinguishing permitted from prohibited rents.

Holding aside the practical difficulties with operationalizing the distinction, most would agree that in exercising its commerce clause powers, Congress is on more solid ground when enacting provisions that affect underlying conduct across more states than one. In fact, the game theoretical model developed below reveals that the theoretical difficulties associated with defining commerce in a manner that properly limits the scope of Congressional commerce clause powers are more problematic than in defining the scope of that term as it applies to the dormant commerce clause. There are two reasons. First, on the affirmative side of the commerce clause, at least if we accept the post-New Deal formulation (even as modified in *United States v. Lopez*[198]), Congress can regulate any economic subject matter that substantially affects commerce. The substantial effects test, as the Court demonstrated throughout the post-New Deal period, raises intractable questions of degrees of impact. Indeed, prior to *Lopez* itself, the difficulty in defining meaningful *categories* had forced the Court into the business of drawing seemingly arbitrary lines.[199] In contrast, the game theoretical account of the dormant commerce clause links permitted and prohibited state legislation not to the extent of harm that particular manifestations of rent seeking impose, but rather to *different kinds* of rent seeking or to whether rent seeking is likely to produce a particular form of interstate effect. Second, and relatedly, in the long course of developing its dormant commerce clause jurisprudence, the Court has identified–wittingly or not–a set of meaningful proxies that correlate with the factual contexts in which these various kinds of rent seeking or rent seeking with particular effects take place.

Articulating the economic foundation for these proxies will allow us not only to provide a positive picture of the present state of the dormant commerce clause doctrine, but also to establish a normatively defensible account for this much criticized body of default constitutional law. The dormant commerce clause, I will argue, has been used primarily as a vehicle with which to check against state laws that have the effect of undermining the laws or dominant practices of other states that would otherwise facilitate the flow of interstate commerce. So viewed, the doctrine is motivated by the effect of challenged laws on the relationships between and among state. It is not motivated by the effect of the challenged laws on the relationship between states and private business interests. And it is for that reason, I claim, that the dormant commerce clause doctrine is fundamentally concerned with political, rather than economic, union.

We can thus appreciate the Court's application of the per se rule when faced with financially motivated facial discrimination, which can predictably invite retaliatory measures by

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[198]514 U.S. 549 (1995).

[199]And of course it remains an open question whether the tripartite *Lopez* formulation will stand the test of time. For a more detailed discussion of *Lopez* and its implications for the dormant commerce clause, see *supra* part II.B.

other states. In these cases, the Court's concern for the legislative reaction in other states, rather than its concern for the economic impact on adversely affected business interests, explains the application of the per se rule. But setting aside such cases, as a general matter rent seeking legislation as such should be presumed beyond the bounds of the dormant commerce clause analysis. That is because while ordinary legislative rent seeking, especially of the sort that distributes wealth from diffuse groups, for example consumers or taxpayers to organized special interests, have an adverse economic effect, the magnitude of that effect is invariably at least as great if not greater at the state than at the national level.[200] But the same cannot be said of the particular category of rent seeking that I contend is of central concern to the dormant commerce clause. Statutes that confer rents that have only become available as a consequence of the pro-commerce laws or practices of other states have an affect on commerce that transcends the economic burdens that such laws impose on the enacting state.[201]

Just as it would be presumptively improper for Congress to intervene in state political processes under the guise of the commerce clause in an effort to minimize the probability that state legislatures pass inefficient rent seeking statutes, so too it would be improper for the federal judiciary, relying upon the dormant side of the commerce clause, to strike down laws that are routine matters of in-state rent seeking. But there are some manifestations of in-state rent seeking that are the proper object of the dormant commerce clause. And it turns out that the Supreme Court has done fairly well–but by no means perfectly–in identifying those factors that correlate with such cases. As stated previously, the dormant commerce clause doctrine has been properly used to strike down state rent seeking laws that have a considerable likelihood of inviting a retaliatory response, thus playing into the most obvious prisoners' dilemma affecting interstate trade. And the doctrine has also been used to isolate for presumptive invalidity those state laws that procure rents in a manner that undermines those Nash equilibrium, pro-commerce laws or dominant practices of other states. To identify the factors that correlate with the latter category of laws, we must introduce, and then generalize, the economic concept of appropriable quasi rents.

A central insight of the transactions costs literature, appropriable quasi rents become available after parties who have entered into contractual relationships under competitive conditions then acquire specialized assets–either human or physical capital–to facilitate performance or receipt of performance of the respective contractual obligations. When this occurs, the parties find their relationship transformed from one entered into competitively into

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[200]And it is perhaps for this reason that state constitutions, in contrast with the United States Constitution, routinely contain provisions that are specifically designed to establish a process for combating excessive in-state rents both before they are negotiated, and after they have been successfully passed by the legislature. Thus for example, state constitutions routinely have provisions that appear nominally intended to limit rent seeking, including various forms of the item veto, term limits, and balanced budget amendments, when such proposals have not succeeded at the federal level. For a discussion of these differences between state and federal legislative processes, see Maxwell L. Stearns, *The Public Choice Case Against the Item Veto*, 49 WASH. AND LEE L. REV. 385 (1992).

[201]And to be clear, I am not suggesting that the Court engage in any sort of impact analysis, as for example, has been suggested by Julian Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L. J. 425, 437-43 (1982). The difficulty with such an approach is that the Court lacks the institutional means with which to assess impact. Instead, I am suggesting that the very proxies that the Court has been using correlate in a meaningful manner with the kind of rent seeking that is of central concern to the dormant commerce clause.

one that is best understood in terms of a bilateral monopoly. Bilateral monopoly is characterized by opportunities to secure rents on both sides of the relationship. As a result, opportunities for strategic, post contractual behavior can plague long term contractual relationships. One of the foundational insights of law and economics has been in recognizing the firm as an institution that ameliorates the difficulties of long term contracting by allowing a single economic entity to coordinate the activities of those who produce positive synergies and then to allocate the gains from their collaborative efforts in a manner that avoids the potential strategic interactions that would plague the same set of relationships if handled contractually.[202] Scholars have also recognized that one of the functions that management provides is in allocating the superadditive gains of contributing factors in a manner that promotes optimal productive incentives within the various components of the firm.[203]

Because the concept of quasi rents is generally used to study private institutions, some translation is required to apply the concept to this important area of public law. And translation always carries with it an attendant risk of loss in meaning. We know, for example, that states do not enter into formal bilateral or multilateral contracts. The compact clause expressly prevents them from doing so without prior Congressional approval.[204] We also know that vertical integration is not an option available to states seeking to prevent strategic behavior by other states in the form of rent seeking legislation enacted at their expense.[205] What then are the circumstances under which states can seek to appropriate the functional equivalent of quasi rents that become available only as the result of the laws or dominant practices of other states? When a group of states have formally or informally undertaken a coordinated pro-commerce regime, a single state can seek to appropriate the resulting quasi rents by enacting legislation that operates to defeat that regime. Such legislation is different in kind from ordinary in-state rent seeking, which merely redistributes wealth internally from diffuse to organized constituencies. This sort of state law confers an in-state benefit that could only have come into being because of the opportunities that the coordinated efforts of other states presented, and any benefit that is conferred is at the direct expense of the other states.

The classic appropriable quasi rent context transforms–or morphs–a competitively entered into relationship into a sort of bilateral monopoly. The contractual relationship itself produces an opportunity for one party to gain at the expense of the other in a manner that is not consistent with either party's ex ante expectations. But this divergence between ex ante and ex post expectations is not limited to formal contracting. The concept of appropriable quasi rents

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[202]*See* Ronald Coase, *The Nature of the Firm,* 4 ECONOMICA 386 (1937), reprinted in THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT (O. Williamson & S. Winter eds 1991); Brickley and Dark, *The Choice of Organizational Form: The Case of Franchising*, 18 J. FIN. ECON. 401 (1987).

[203]*See* Oliver Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J. LAW ECON. & ORG. 233 (1979).

[204]The compacts clause states: "No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State . . . ." U.S. CONST. ART. 1, § 10, cl.3.

[205]In fact, while single states have divided throughout our history, never once have two or more states merged.

can be generalized to include a second context–empty core bargaining or cycling–in which a single player can secure a gain that thwarts what would otherwise have been a mutually beneficial regime achieved through formal or informal coordinated efforts among multiple players.

In the context of interstate rent seeking, empty core bargaining or cycling has the potential to arise when three or more states would benefit from a common legal regime and when a single state, by defecting from that regime, can prevent the other states from realizing those benefits. Using the language of game theory, the common legal regime produces a superadditivity, meaning an additional value that could not be realized if the individual states failed to coordinate their efforts.[206] The superadditivity is much like a capital gain in that it presents the actors with a chance to increase the return to capital simply by coordinating the use of that capital with others. But with the creation of the capital gain comes the problem of allocation, and thus the incentive to seek appropriable quasi rents. If a group of states shares a common legal regime that has the effect of facilitating a capital gain or superadditivity, for example that arising from a coordinated flow of commerce facilitated by a regime that permits a widely used variety of truck, mudflap, maximum shipment weight or maximum train length, a single state in the middle of this group can effectively undermine the benefits of the coordinated scheme, taking a substantial amount of the available gains onto itself, simply by enacting a contrary rule.[207] The problem is particularly acute in coordination games in which from a reasonable ex ante perspective, all would agree to one of two or more Nash equilibrium strategies, but in which a defecting state can benefit from the mere fact of introducing a mixed regime. The analysis shows that the defecting state is not seeking to supplant one possible Nash outcome with another, but rather to thwart the gains to other states by producing a result that is mixed, and thus non-Nash.

If, for example, there is a benefit to a state to not having trucks in interstate commerce travel through it, either because of the reduction in the flow of traffic or because of the reduction in the cost of highway maintenance, then the contrary law takes on the characteristics of appropriable quasi rents produced as a result of the Nash equilibrium, pro-commerce strategy of the other states. The opportunity for the rent could not have come about but for the dominant practices of other states, which the defecting state seeks to thwart. The divergence between ex ante and ex post expectations is highlighted if we consider that no reasonable set of legislators,

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[206]For a general discussion of core theory, see LESTER G. TELSER, ECONOMIC THEORY AND THE CORE (1978); *see also* John S. Wiley, Jr., *Antitrust and Core Theory*, 54 U. CHI. L. REV. 556 (1987).

[207]For an alternative, but generally consistent, analysis that couches this problem in terms of hold outs and the need for universal assent among states as a precondition to the success of certain interstate business ventures, see Richard Epstein, *Exit Rights Under Federalism*, 55 LAW & CONTEMP. PROBS. 147 (1992); see also Dan Burk, *Federalism in Cyberspace*, 28 CONN. L. REV. 1985 (1996). In his article, Professor Epstein offers a coordination analysis of *Kassel* and *Bibb* as part of a larger study of how, counter intuitively, federalism can occasionally undermine rather than promote exit strategies for businesses. Epstein's analysis largely rests on an application of the hold out phenomenon to the production of a multi-state public good that facilitates interstate business transactions or the flow of commerce. Professor Epstein does not place these cases within the broader context of the dormant commerce clause doctrine or assess other case outcomes according to the various manifestations of rent seeking explored here. For a discussion that distinguishes these two approaches, see *infra* at 75.

had they been given the power to legislate for the entire group of states, including the defecting state, would have selected a regime in which one state in the center has a rule that is out of sinc with those of the surrounding states. And state highway safety laws are not the only context in which the laws of other states create potential opportunities to secure appropriable quasi rents.

A critical insight that follows from this analysis is that, contrary to traditional doctrinal approaches to the dormant commerce clause, the relevant inquiry should not be whether the subject matter of the challenged statute–whether it be truck safety regulations, the quality indicators for imported produce, or gasoline marketing–implicates the commerce clause versus state police powers. This question is unanswerable. Instead, the better inquiry is whether, without regard to the statutory subject matter, the challenged statute seeks to secure a quasi rent that would not have become available but for the laws or dominant practices of other states.

The analysis further explains why the dormant commerce clause is necessarily a default doctrine of constitutional law. Because much dormant commerce clause jurisprudence is targeted against opportunities to secure appropriable quasi rents, and because such rents can arise from coordinated schemes that would potentially admit of more than one possible Nash equilibrium strategy,[208] the decision by one group of states to select a particular regime should not prevent Congress from changing from one such coordinated outcome to another. Provided that the outcome remains coordinated, and thus Nash, for example, either to allow straight or curved mudflaps (or to allow both), then the objectives of the commerce clause are met.

While Congress is well situated–better for example than the federal judiciary–to monitor and change dominant legal regimes, it might be less well situated than the federal judiciary to monitor and punish states that seek to secure rents at the expense of other states. Public choice reveals that in situations that present intense conflicting lobbying pressures on both sides of a given issue, a common legislative response is to either decline to legislate altogether, or to delegate.[209] Interstate disputes over commerce present just this sort of conflict paradigm. And the dormant commerce clause doctrine can be interpreted in a manner that is consistent with either of these Congressional responses. Failing to legislate solutions with the knowledge that the federal judiciary stands ready to intervene in response to efforts by states to appropriate quasi rents made available as a consequence of other states' Nash equilibrium, pro-commerce strategies is the operational equivalent of a silent, or de facto, delegation. The difficulty, as we have seen, however, is that all state laws that are challenged as violating the dormant commerce clause can be characterized as a form of rent seeking because virtually all such laws share the characteristic of redistributing wealth from one group that is diffuse and poorly organized to another that is concentrated and well organized.[210]

In the course of developing its dormant commerce clause jurisprudence, the Court has articulated tests that operate as stronger or weaker presumptions of validity or invalidity. This is

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[208] *See* DOUGLAS G. BAIRD, ROBERT H. GERTNER, AND RANDAL C. PICKER, GAME THEORY AND THE LAW 19-28 (1994).

[209] *See* Peter Aranson, Ernest Gellhorn, Glen O. Robinson, *A Theory of Legislative Delegation*, 68 CORNELL L. REV. 1 (1982).

[210] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1965) (setting out this thesis in rigorous detail).

captured in Table 3, which presents four sets of rules, which are often inconsistently applied. As Table 4 reveals, once we introduce the most prominent doctrinal exceptions to the Court's dormant commerce clause doctrine, the apparent inconsistencies become even more pronounced. In short, the doctrine operates as a meaningful guide only if we accept at face value the Court's articulated exceptions. And those exceptions often appear hard to defend when we consider them in light of the Court's own dormant commerce clause analysis. But, I will argue, if we instead employ the game theoretical model developed more fully below, we can line these cases up along two complementary analytical spectrums. The two spectrums turn on the presence or absence of the best available proxies for laws that, if sustained, are likely to provoke a retaliatory response from other states or laws that represent state efforts to appropriate quasi rents that have become available only as a result of other states' Nash equilibrium, pro-commerce regimes. Let us now begin.

B. Developing the Game Theoretical Model

1. The Prisoners' Dilemma

The prisoners' dilemma characterizes the conditions under which rational behavior leads two players to pursue individual strategies that yield outcomes for each player that are inferior to those associated with mutual cooperation. The payoffs in the standard prisoners' dilemma are such that without regard to what the other prisoner does, it is rational for each prisoner to defect. To illustrate, assume that two prisoners are separated and are prevented from communicating with each other. Each prisoner is told that if neither confesses, the state will be limited in its proof, and each prisoner will receive 6 months based upon a conviction for a minor offense. If one rats out the other while the other remains silent, the one who speaks will go free, while the other will get 8 years. If both rat out the other, each will get 6 years. These reciprocal payoffs are presented in Table 5.[211]

Table 5: The Prisoners' Dilemma

(Payoffs for A,B)	A cooperates	A defects
B cooperates	(6 months; 6 months)	(no time; 8 years)
B defects	(8 years; no time)	**(6 years; 6 years)**

The prisoners' dilemma reveals that without regard to what the other prisoner does, it is rational for each prisoner to defect. If B is silent, A can improve her position from 6 months to no time by ratting out B. If B defects, A can improve her position from 8 years to 6 years by ratting out B. The payoffs are reciprocal and therefore B has the same incentives. The end result is that both A and B are motivated to defect even though mutual defection produces a payoff for each prisoner (6 years) that is substantially lower than that available if the two prisoners instead

[211]Please note that in Table 5, cooperation and defection are presented with reference to the remaining prisoner, rather than the police. Thus, cooperation means declining to rat out the other prisoner; defection means the opposite.

pursued a strategy of mutual cooperation (6 months).[212] The lower right box, which represents the dominant set of strategies, is presented in bold.

Several legal scholars have recognized that the prisoners' dilemma characterizes the relationships that confront states,[213] and nations,[214] in choosing whether to enact special interest legislation that limits free trade. Other scholars who have not formally relied upon game theory in their analyses have identified dynamics within the dormant commerce clause doctrine that can readily be recast in such terms.[215] While each state would be better off in a free trade regime, one

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[212]As stated in the text, the prisoners' dilemma is built on the assumption that the prisoners cannot cooperate and that any implicit agreements cannot be enforced. The problem could be avoided in a regime in which the prisoners can reward cooperation and punish defection, as seen in the iterated prisoners' dilemma game. While this game is discussed in more detail below, see *infra* at 60-61, it is important to emphasize two points here. First, infinite iterations do not solve the prisoners' dilemma; rather, by providing enforceable rewards for cooperation and punishments for defection in the next successive period, they alter the payoffs such that the game no longer is a prisoners' dilemma. Second, the iterated prisoners' dilemma game achieves a cooperative result only if there is no known end period. If the players know the end period, or can safely anticipate a probable end period, then the game "unravels" such that every period is subject to single period prisoners' dilemma payoffs. When this occurs, mutual defection is again the dominant strategy.

[213]*See, e.g.,* Peter D. Enrich, *Saving the State from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377 (1996) (relying upon prisoners' dilemma analysis to argue that the proper test for evaluating state law tax incentives "should be whether a particular tax provision distorts economic decision-making in favor of instate activity, not whether it treats in-state and out-of-state actors disparately."); Daniel P. Petrov, *Prisoners No More: State Investment Relocation Incentives and The Prisoners' Dilemma*, 33 CASE W. RES. J. INT'L L. 71 (2001) (arguing that states might not face a prisoners' dilemma concerning relocation tax incentives); Richard E. Levy, *Theories of Federalism: Federalism and Collective Action*, 45 KAN. L. REV. 1241 (1997) (positing that "the expansion of federal authority under the Commerce Clause makes sense from a collective action perspective because of externalities and the prisoner's dilemma (or race to the bottom) problems.").

[214]*See, e.g.,* AXELROD, *supra* note 111, at 5-6, 16 (describing trade relationship between nations as prisoners' dilemma).

[215]Thus, for example, Professors Dan T. Coenen and Walter Hellerstein have addressed the question why the Supreme Court allows state subsidies but not tax breaks under its dormant commerce clause doctrine. *See* Dan T. Coenen, *Business Subsidies and the Dormant Commerce Clause*, 107 YALE L. J. 965 (1998); Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789 1996). Professor Coenen notes that

> Tax credits, exemptions, and the like are resistant to repeal because legislatures typically enact them as presumptively permanent features of state tax codes. In contrast, because subsidies involve the direct expenditure of funds, they routinely show up–and are subject to recurring reevaluation–as expense items in perenially controversial state budget bills.

Coenen, *supra* at 986. Similarly, Hellerstein and Coenen argue that "[j]ust as surely as use of the will or the deed impresses upon the individual mind the significance of its contemplated act, consideration of a subsidy forces the mind of the public body to consider most pointedly the cost and consequences of moving forward." Hellerstein & Coenen, *supra* at 869. While scholars have rightly noted that subsidies and tax breaks "may have the same effects," Saul Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 566 (1983), the Coenen and Hellerstein analyses suggest that the process through which the rent seeking law is created might affect the probability of reciprocal behavior by other states. *See also* Regan, *supra* note 32. So viewed, the more transparent special interest legislation is, the more costly it is to procure. As a result, transparent rents are less likely to invite a retaliatory response from other states. Conversely, the more well hidden the rent, the less costly it is to procure and

that promotes specialization and exchange, than in one of mutual defection, free trade regimes also have distributive consequences that can adversely affect particular industries that would fare poorly with direct competition from other states. Such industries have a strong incentive to secure legislation at the state level that will insulate them from interstate competition. As a result, special interests are strongly motivated to pressure their state legislatures to defect from the norm of free trade. And while such protectionist legislation harms diffuse constituents who are deprived of the superior products and lower prices that open trade brings, the extent of harm to any individual is likely to be sufficiently small that it will be less worthwhile for diffuse constituents to invest in lobbying to oppose protectionist measures than it will be for special interests who directly benefit to lobby in their favor. This familiar public choice insight,[216] reveals that behaving rationally, state legislatures are likely to provide protectionist legislation even though the aggregate effect is welfare reducing. States that enact such legislation are responding rationally to interest group pressures, but if all states react in this manner, the effect is economic balkanization, the game theoretical equivalent of mutual defection in a multilateral prisoners' dilemma game.

Players can avoid the prisoners' dilemma through unlimited repeat plays in which they anticipate the ability to punish the defector in any given period in the subsequent round of play. In a game with endless iterations, the anticipated punishment that will necessarily follow from any defection alters the payoffs by reducing the benefits of defection and increasing the benefits of cooperation. The altered payoffs have the potential to produce a matrix in which it is rational for each player to pursue a cooperative strategy regardless of what the other player does. If so, mutual cooperation emerges the dominant strategy. If instead, however, the game has a known end period, the game "unravels." If, for example, there are six periods, in the sixth and final period, the players behave as if there is no more opportunity to punish (because there is no seventh period), and therefore rationally defect. In period 5 (or *n-1*), the players again realize that there is no opportunity to punish, because they anticipate mutual defection in period 6 regardless of what happens in period 5. The same problem confronts the players in periods 4, 3, and 2. Eventually, this continues down to the first period, thus ensuring that the entire game will fall victim to mutual defection as the dominant outcome.[217]

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thus the more likely it is to provoke retaliation. This somewhat counterintuitive observation (that hidden laws are more likely to invite retaliation than transparent laws), can be explained in terms of the prisoners' dilemma. Interest groups have a strong incentive to identify even well hidden rent seeking laws that adversely affect them in other states and to secure reciprocal protectionist measures in their own state. The Court's dormant commerce clause doctrine is consistent with this observation in that it appears to raise the cost to interest groups of securing retaliatory special interest legislation that is consistent with a regime of mutual defection in a standard prisoners' dilemma. For a more detailed discussion, see *infra* part IV.B.1.

[216]For general discussions, see MAXWELL L. STEARNS, PUBLIC CHOICE AND PUBLIC LAW: READINGS AND COMMENTARY 540-46 (1997) (describing legislative prisoners' dilemma); OLSON, *supra* note 207 (describing tendency of organized groups to secure special interest legislation at the expense of diffuse groups).

[217]For a general discussion, see STEARNS, *supra* note 213, at 540-46. The presentation in the text is admittedly stylized. As behavioral economists have observed, known or anticipated end periods do not invariably result in a defection regime. *See* Ronald J. Gilson & Robert H. Mnookin, *Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 COLUM L. REV. 509, 520 (1994). The authors explain that in contrast with formal models, "[m]ore recent research . . . suggests that cooperative behavior can develop in a multi-

In the context of interstate trade, the single period prisoners' dilemma likely provides a more apt description than a game with unlimited iterations or even than an unraveling game. While the states are repeat players, laws that cater to narrow constituencies in most instances arise stochastically. In most instances, state A is unlikely to reciprocate in kind to state B in response to a particular law that state B has enacted affecting state A. In *Hunt*, for example, while the challenged North Carolina law targeted Washington apples, it is unlikely that Washington had a direct and ready means of punishing North Carolina for that isolated instance of defection. Because we are dealing with 50 states, rather than 2, each state likely views itself as playing in what is effectively a single period prisoners' dilemma with respect to potentially adverse trade laws of any particular state. This holds even if any given state is a repeat player with respect to the remaining states in general.[218]

At a minimum, the dormant commerce clause doctrine can be understood as a judicial effort to prevent states from enacting laws that, if sustained, threaten a regime of mutual defection in a standard, noniterated prisoners' dilemma game. If states were immune from challenge in enacting discriminatory legislation that is motivated by a protectionist purpose, as is widely understood to have been the case under the Articles of Confederation,[219] then notwithstanding the aggregate gains to the individual states and to the nation as a whole from free trade, each state would instead have an incentive to cater to narrow constituencies, thus defecting from that norm. The mutual incentives to defect from a regime of free trade would threaten to produce the lowest payoffs by isolating each state as an economic unit.

While this story is widely understood, the fact remains that it fails to capture most, or at

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round prisoner's dilemma under certain conditions." *Id.* at 520. Depending on the payoff function, cooperation can result if the players in any given round suspect a high possibility of a subsequent round in which cooperation can be rewarded and defection can be punished. *See id.* Fortunately, it is unnecessary here to reconcile the formal models with the claimed contrary results from behavioral economics research. As explained in the text that follows, the single period prisoners' dilemma better captures the relationships between and among states not due to unraveling, but rather due to the stochastic nature of opportunities for retaliation against another state's isolated but harmful protectionist measure.

[218]There are exceptions. For certain exports, trade between adjacent states is more likely than trade with distant states. In that context, reciprocal punishments become more plausible. This issue arises in the context of reciprocity statutes. *See supra* part II.C.1.b and *infra* part IV.B.3.c.

[219]It is contested historically whether in fact the Articles were unduly plagued by state laws obstructing interstate trade. *See* Edward Kitch, *Regulation and the American Common Market*, in REGULATION, FEDERALISM, AND INTERSTATE COMMERCE (A. Tarlock ed. 1981). Without attempting to resolve this historical debate, my own intuition is that it is more relevant to identify what the framers feared than it is to determine whether their fears were well grounded in historical experience. *Accord* Regan, *supra* note 32, at 1114 n.55 (1986). It is also worth noting that to the extent that trade barriers did motivate the enactment of the Constitution, some have argued that the import-export clause, rather than the commerce clause, was directed at such offensive state law practices. *See* BITTKER, *supra* note 83, at § 6.06, 6-35-36. It is for that reason that Professor Bittker contends that the reference to free markets in the famous Justice Jackson quote from *H.P. Hood & Sons v. DuMond*, 336 U.S. 525, 539 (1949), *see supra* note 83, and accompanying text, for quote, "may stretch history a bit." Bittker explains:

> The "commercial strife" that the Constitution was expected to pacify consisted primarily of taxes laid by seaport states on products in transit to and from inland islands–a fiscal measure that, of course, inured to the benefit of the residents of the taxing states, but in the form of revenue, not by aiding local producers; and the tax malady was addressed explicitly by the Import-Export Clause.

BITTKER at 3-35-36.

least the most interesting, cases. At one level that should not be surprising. If the legal doctrine solves an easy category of cases, then the doctrine should be credited rather than faulted when its obvious target cases fail to arise. So viewed, we might appreciate the per se rule of invalidity, set out in category 1,[220] which applies to facially discriminatory statutes that are motivated by a protectionist or economic purpose, as the Court's effort to use the dormant commerce clause to prevent a mutual defection outcome in this prisoners' dilemma game.

Because most cases do not present such blunt attempts at discrimination in commerce, we can appreciate the Court's use of strict scrutiny as a presumption against those state laws that likely represent creative state legislative efforts to produce the same result through means that would otherwise be more likely to withstand judicial scrutiny. Thus, the Court applies strict scrutiny, presuming against the constitutionality of laws that discriminate in commerce, but that are arguably linked to some other legitimate purpose (category 2) and against the constitutionality of laws that although facially neutral, appear to have been motivated by protectionist or financial concerns (category 3). In cases that fall into these two categories, the Court intuits that sophisticated state legislatures have packaged otherwise harmful state laws in a form that avoids the strictures of the per se rule. Strict scrutiny thus raises the cost of mutual defection by signaling close review based upon the nature or object of the challenged state law.

While the prisoners' dilemma thus advances our understanding of the dormant commerce clause doctrine, it provides only a partial explanation. Three problems remain. Two involve the prisoners' dilemma theory itself. The third requires a complementary game theoretical account that involves a different type of defection strategy from a regime of beneficial cooperation. I will now summarize each of these limitations with the traditional prisoners' dilemma account.

First, in the context of waste disposal, a rule that prevents states from discriminating in commerce does not necessarily transform a potential regime of mutual defection into a probable regime of mutual cooperation. That is because states that are prohibited from discriminating against waste based upon point of origin retain an alternative outlet for discrimination. As long as states retain the ability to decline permit applications, forcing states to regulate neutrally or not at all might have the effect of introducing the same prisoners' dilemma in alternative form. While all states might in theory benefit from a regime of open commerce in waste disposal, if each state knows that others are permitted to deny permit applications, thus closing off in-state waste disposal facilities, it becomes rational to follow the same strategy. So viewed, cases like *City of Philadelphia v. New Jersey*,[221] and *C&A Carbone v. Clarkstown*,[222] might have the perverse effect of limiting, rather than expanding, outlets for waste by removing the incentives that states would otherwise have to approve waste processing permits if they could capture the entire benefit of doing so by ensuring that the waste outlet would service only those who traffic in or produce waste within the state.

Second, in the context of reciprocity statutes, states have undertaken a regime that imposes limits on their partner states in pursuing a defection strategy. While state A's reciprocity

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[220]*See supra* Tables 3 and 4.

[221]437 U.S. 617 (1978).

[222]511 U.S. 383 (1994).

statute, providing that it will ensure free trade with state B only if state B ensures free trade with state A, does not undermine the incentives of special interests to lobby for protectionist legislation in its various forms, it does raise the costs to legislators in providing it. Instead, the tit-for-tat game reveals that such statutes provide a filter that requires state legislators to account for those who would be harmed by the restrictive trade practices that will follow from their protectionist measures in the other state.[223] The Court's rejection of these laws, unless Congress has approved them, further undermines the power of the prisoners' dilemma to provide a complete account.

Third, and finally, a significant category of cases in which the Court strikes down the challenged state law simply fail to fit a prisoners' dilemma paradigm. Most notably, the burden on commerce cases, for example the prohibition of 65-foot twin trailers struck down in *Kassel*, the requirement of curved mudflaps struck down in *Bibb*, and the train length limit struck down in *Southern Pacific* do not threaten to invite others to follow suit. In fact, in each of these cases, the Court struck down the challenged law because other states had adopted an opposite strategy. In short, if game theory is to do the work of explaining the dormant commerce clause doctrine, we need to expand its reach. In the next subpart, I will offer a complementary game theoretical model that also draws upon elements of price theory and the theory of transactions costs.

1. The Multiple Nash Equilibrium Game

We will now introduce more formally the second game that will help us to understand the Court's dormant commerce clause jurisprudence. As stated previously, it is helpful to apply a common framework, that of rent seeking, to each set of case facts. This will allow us to distinguish those rents that are benign from those that are illicit, and between those that although illicit are beyond the reach of the dormant commerce clause from those that are properly within its scope. In the multiple Nash equilibrium game, the players, without any formal coordination, have an incentive to pursue a common strategy to achieve higher payoffs from either of two or more Nash equilibrium outcomes relative the low payoffs associated with the alternative mixed strategy equilibrium outcomes. To illustrate, let us return to the driving game.[224]

Imagine that automobiles are in their infancy and that no law or custom yet establishes whether to drive on the left or right side of the road. Assume a world with two drivers who must decide upon which of four possible combined driving regimes, presented in Table 6, to adopt. Further assume that neither driver much cares about which side he or she drives on, but that for reasons of personal safety, both care greatly that the two drivers adhere to the same driving regime. When the drivers opt for the same regime they each receive a payoff of 10, but when they opt for different regimes, they each receive a payoff of zero. Unlike the prisoners' dilemma game presented in Table 5, in which the single outcome of mutual defection represents a stable equilibrium outcome, in the driving game, two of the possible four combinations (represented in the upper left and lower right quadrants) represent stable Nash equilibria. Conversely, the two mixed strategy equilibria (represented in the lower left and upper right quadrants) are unstable because the second mover could improver her payoffs by moving to the initial mover's preferred

[223]*See Axelrod, supra* note 111.

[224]*See supra* at 6.

regime.[225] If A drives right and B begins driving left, B can then again increase her payoffs from 0 to 10, this time by changing to the right driving regime. The same incentives apply if A drives left and B begins driving right, or if B is the initial mover, whether she chooses right or left. As in Table 5, the Nash equilibrium results are presented in bold.

Table 6: The Driving Game

(Payoffs for A,B)	A drives left	A drives right
B drives left	**(10,10)**	(0,0)
B drives right	(0,0)	**(10,10)**

If we now consider a multiple Nash equilibrium game that involves the states, rather than individuals, as players, the question arises what is the nature of any rent seeking that would encourage one state to defect from the benign cooperative regime pursued by other states. To answer that question, it will be helpful to introduce more formally the concept of appropriable quasi rents, which grows out of the transactions cost literature.[226]

Appropriable quasi rents are generally employed to explain the development and structure of firms, but has also been fruitfully used to explain various types of long term contracts, for example, those involved in licensing agreements or franchises. The essential insight is that individuals, or individual companies, entering into contracts under competitive conditions, often specialize their assets to facilitate performance under the contract. Thus if Bob contracts to paint Sue's house, Bob will purchase the necessary equipment, which will include a particular color of paint, appropriate brushes, a ladder, sanding materials, and the like. It is possible that all of these materials can be readily used on other jobs, such that if Sue reneges, Bob can redeploy any assets that he has acquired in anticipation of performing his contract with

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[225] I do not intend to suggest that whenever actors confront games presenting multiple Nash equilibria, the result is invariably a Nash equilibrium outcome. It is possible that if each player tries to anticipate the other player's dominant strategy, but does so incorrectly, that the resulting regime will be a mixed strategy equilibrium *even though* each player has attempted to achieve a pure Nash equilibrium outcome. Professors Baird, Gertner, and Picker have explained this phenomenon as follows:

> One can point to games in which the unique Nash equilibrium may not be the combination of strategies that the players would in fact adopt. Moreover, the Nash solution concept often does not identify a unique solution to a game. When there are multiple Nash equilibria, we may not be able to identify one of these as that which the players are likely to choose. Indeed, when there are multiple Nash equilibria, there is no guarantee that the outcome of the game is going to be a Nash equilibrium. Each player, for example, might adopt a strategy that is part of a different Nash equilibrium, and the combination of strategies might not be Nash.

BAIRD, *supra* note 205, at 22. In the hypothetical in the text, I have avoided this difficulty by presenting the decision of the two drivers sequentially, rather than simultaneously. Because the drivers are assumed to care only about sharing a common driving regime, whether right or left, sequential decision making increases the probability of achieving a Nash outcome.

[226] *See supra* notes 199 and 200, and cites therein; *see also infra* notes 227 and 228, and cites therein.

Sue at little or no additional cost. This is most likely if Sue selected a neutral color, if her home was in a standard development, and if it had no unusual architectural features requiring customized equipment for access to areas in need of painting. While this might well characterize most contracts to paint a home, it certainly does not capture all such contracts or all contracts generally. In addition, the party who is seeking performance is also forced to customize. When Ann considers purchasing a new car, she has a wide range of choices. She can select not only the make and model, but also who will perform necessary service. But once the purchase decision has been made, her service options become more limited. Depending upon the nature of the warranty, for example, she might be required to have all service work completed at a licensed dealership. If so, Ann has specialized her receipt of services to the dealership, thus inviting the dealership to seek to procure appropriable quasi rents. Most contractual arrangements require at least some level of customization in anticipation of performance, or of receipt of performance, and the degree of that customization can vary considerably from contract to contract. The degree of customization, and the anticipated losses associated with sacrificing the economic benefits that one anticipated in specializing, are the causal factors that give rise to opportunities to appropriate quasi rents.

To illustrate, assume that Sue lives in an old Victorian home painted in a color that is sufficiently uncommon that it must be custom mixed, with architectural features that render access impossible without special equipment, and with wood that is no longer commonly used to build but that is need of repair or replacement. To complete the job, Bob is required to make significant performance-specific investments. Assume for example that the contract is for $15,000, including supplies, and that the nonstandard supplies will cost Bob $2500. Bob might be able to return or sell off some specialized supplies in the event that Sue reneges, for example, special ladders. But other supplies, for example, the custom mixed paint and the supplemental wood, are of little or no value other than as used in the performance of the contract with Sue. If Bob could only recover $500 of the $2500 contract-specific investment, and if cost and inconvenience of litigating exceed the difference of $2000, Sue could force Bob to incur up to that amount in additional performance costs as her appropriable quasi rent. Bob would be willing to perform unanticipated work up to that amount before it would be economically feasible for him to withdraw on the ground that the additional demands constitute a material breach.

As stated above, the same phenomenon can arise in the other direction. Thus, if Ann has purchased a lemon, and if it would cost the dealership an additional $2000 to repair the car properly above whatever the cost of repairing it sufficiently to get the car through the warranty period, then assuming the cost of legal recourse to Ann exceeds $2000, the dealership can again seek to appropriate the quasi rents created through the bilateral contracting relationship by shirking in its performance up to that amount.

I do not intend to suggest that the parties in these situations can not devise contractual or other solutions to these sorts of difficulties as a means of limiting the opportunities on the other side to secure such rents. Indeed, my point is the opposite. Parties can and do devise any number of arrangements to avoid the difficulties that are associated with minimizing opportunities for post contractual strategic behavior that result from appropriable quasi rents. And these solutions are remarkably varied. Within the economics literature, several important studies have identified the conditions that give rise to these sorts of post contractual strategic bargaining, and the nature

of various market solutions.[227]

We can imagine Bob avoiding the problem with Sue by insisting that she purchase all customized materials and that he deduct the cost of those materials from the contract price. By arranging the contract in this manner, he will negatively affect Sue's overall costs,[228] but will avoid a potential cost in the form of strategic behavior that can result in bargaining for a sum up to the amount of the appropriable quasi rent. Similarly, we can imagine the automobile dealership bonding itself by providing a warranty and a contract that specifies a low cost mediator in the event of shirking in servicing the vehicle.[229] And there are other more complicated solutions, depending upon the nature and depth of the problem. In the context of franchising, for example, in which the franchisor anticipates that some franchisees might shirk in ensuring quality output, thus compromising the brand name, we can imagine contract provisions that require all inputs be purchased from the franchisor along with periodic quality checks. To avoid the potential appropriable quasi rent that could then result on the other side from raising costs above the market price for supplies, we can imagine linking the cost of supplies to some identifiable economic indicator, or fixing the annual rate of increase in advance. And of course for some truly complicated contractual relationships, those involving a protracted performance period and an inability of the parties to anticipate the precise conditions that create appropriable quasi rents, we can imagine vertical integration, or establishing a firm. This approach optimizes the use of superadditive gains, while reducing the feared depletion of quasi rents through mutual strategic behavior.[230]

The benefits of the firm in minimizing opportunities for strategic behavior among long term contracting parties are well known, and are the focus of a large literature.[231] The critical point for present purposes is that merging institutions that would otherwise suffer contracting

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[227]*See supra* notes 199 and 200, and cites therein; *see also infra* notes 227 and 228, and cites therein.

[228]And in fact he might affect her cost in a favorable manner. If we assume that Bob would include some premium to cover the contingency of post contractual opportunistic behavior, then minimizing the opportunities for Sue to engage in such behavior can allow him to avoid adding that premium, thus lowering the contract price. So viewed, optimal contracting arrangements can reduce contracting costs by the product of the probability of producing an appropriable quasi rent times the costs that would be imposed if the rent were realized. By reducing the contract price, the suggested purchasing arrangement is thus welfare enhancing.

[229]There are also other, noncontractual, methods of signaling to prospective purchasers that a dealership, or manufacturer, is unlikely to shirk. A program of certified pre-owned vehicles with extended warranties that operate for a significant number of years or miles informs the prospective purchaser that the dealership retains an interest in the sold or leased vehicle even after the initial contract.

[230]*See* Benjamin Klein, Robert G. Crawford and Armen A. Alchian, *Vertical Integration, Appropriable Quasi Rents, and the Competitive Contracting Process*, 21 J. LAW AND ECON. 297 (1978); Williamson, *supra* note 200.

[231]*See, e.g.,* Klein, supra note 227; Williamson, *supra* note 200. The terms "appropriable" and "expropriable" quasi rents are sometimes used interchangeably. See, e.g., Armen A. Alchian, *Decision Sharing and Expropriable Quasi-Rents: A Theory of First National Maintenance Corp. v. NLRB*, 1 SUP. CT. ECON. REV. 235 (1982); Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism,* 76 VA. L. REV. 265, 290 (1990).

difficulties is a ready solution in the event that separate contract provisions prove inadequate to meet the needs of the parties. The effect of uniting productive resources within a single firm, like contractual solutions in less complex settings, is to promote behavior that is more consistent with the parties' ex ante expectations, thus preventing the depletion of unnecessary resources in performance through efforts to secure appropriable quasi rents or through insuring against such contingencies. As seen below, in the public law setting, splitting institutions is often an equally important response to the problem of avoiding strategic behavior. Specifically, supplemental institutions, like the federal judiciary in the dormant commerce clause context, often operate to devise solutions that the parties would likely have agreed to in advance, but that they are now unable to reach because one or the other has a rational incentive to behave strategically.

Before proceeding to other forms of rent, it is important to reiterate that appropriable quasi rents become available only after the parties to a contract have selected each other as partners and ironed out their contracting terms, presumably under competitive conditions. The rent opportunity arises as a function of the contractual relationship that has been formed. And once the contract has been formed, the parties are suddenly in a specialized relationship in which the competitive conditions that initially gave rise to the contract no longer hold.[232]

The central insight that emerges from this analysis is that while parties have many choices at the stage of entering into even complex contractual relationships, once the contractual relationship is formed, the more the contract requires for its performance specialization of physical assets or of human capital. As a consequence of that specialization, it becomes more likely that the relationship will be transformed by the contract itself from one characterized by competition into one that more closely resembles a bilateral monopoly. The contract transforms the relationship because while the contract itself produces a gain from trade to each party, the necessary specialization for completion of the contract, or for anticipating competion by the other side, creates an opportunity for the strategic player to behave in a manner that will allow him or her to receive a portion of the contractual gain that was, at the time of contracting, intended for the other party. But contracting is not the only means of creating wealth between parties, and post contractual strategic bargaining is not the only opportunity to strip other parties of the gains that they reasonably anticipated from their interactions with others.

We can now state the problem in more general terms. Quasi rents are created and become subject to appropriation when the relationship between the parties creates an increase in wealth, but when that relationship itself provides an opportunity for one party to secure a part of that increase in wealth at the expense of the other party in a manner that was not reasonably

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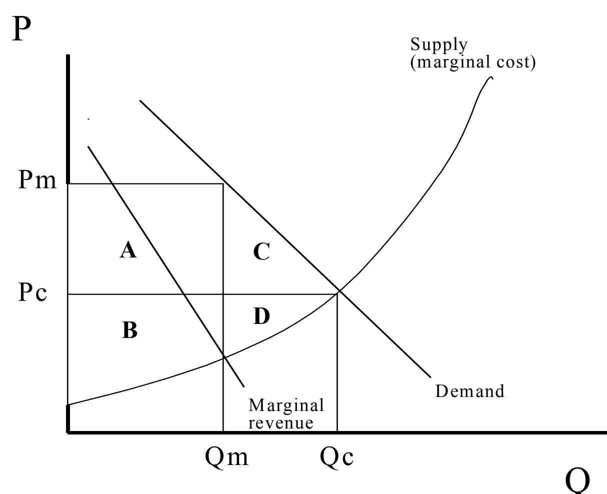
[232]Oliver Williamson has captured this intuition as follows:

> Idiosyncratic goods and services are thus ones where investments of transaction-specific human and physical capital are made and, contingent upon successful execution, benefits are realized. Such investments can and do occur in conjunction with occasional trades where delivery for a specialized design is stretched out over a long period (for example, certain construction contracts). The transactions that I wish to emphasize here, however, are exchanges of the recurring kind. Although large-numbers competition is frequently feasible at the initial award stage for recurring contracts of all kinds, idiosyncratic transactions are ones for which the relationship between buyer and supplier is quickly *transformed* into one of bilateral monopoly–on account of . . . transaction-specific costs. . . . This transformation has profound contracting consequences.

See Williamson, *supra* note 200, at 241.

Figure 1



engaging in marginal revenue, or monopolistic, pricing. Such a pricing strategy means that the firm reduces the level of output associated with competitive conditions, in which supply (or marginal cost) meets demand, to the point where marginal revenue meets marginal cost. If we assume that the firm is unable to engage in price discrimination, then the firm faces a downward sloping marginal revenue curve as a consequence of its need to reduce the price for all purchasers as it sells more of its goods along the downward sloping demand curve. Because the firm must reduce the price for each additional unit sold, its revenue declines as it increases its output. The price maximizing strategy for the monopolistic firm is to set output where supply, or marginal revenue, meets marginal cost. This will allow the profit maximizing firm to then set a monopolistic price along the corresponding demand curve. In Figure 1, the monopoly price and output are indicated by Pm and Qm respectively, as compared with Pc and Qc under a non-monopoly pricing strategy. The monopoly profit is indicated by regions A plus B. Welfare economists are concerned about a monopolistic pricing strategy because it creates a welfare loss triangle, representing the additional amount consumers would pay for increased production under competitive production (region C) and the additional revenue that producers would receive as a consequence of that production (region D).

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[233]For a more detailed presentation these various forms of rent, with accompanying graphical depictions, see STEARNS, *supra* note 213, at 113.

To distinguish monopoly profit from monopoly rent, we must now introduce Ricardian rents. Even under competitive conditions, meaning only that individual firms are price takers, some producers have greater productive talents or resources than others. Some farmers have superior land or live stock; some laborers have superior strength or talent; and, most significantly for our immediate purposes, some states have superior natural resources, whether for export, for example, water or coal, or for import, for example, land conditions that are better suited for long term waste storage. Thus, for any given price set by competitive market conditions, some market suppliers will profit more than others as a function of superior resources or skill. As a result, some producers are capable of generating greater "profit" even if they cannot set price. This additional profit is known as Ricardian rent. In Figure 1, Ricardian rents are represented in regions B plus D. Monopoly rent is the difference between monopoly profits and Ricardian rents, which is the profit such firms would receive under non-monopoly pricing. To calculate monopoly rent, therefore, we must subtract from the monopoly profit (A plus B) the Ricardian rents (B plus D). Because (A + B) - (B + D) = (A - D), region A minus region D in Figure 1 represents the monopoly rent.

With this introduction to the various forms of rent, we can now define rent seeking. Rent seeking is the process of attempting to secure legislative protections that provide a value to the firm or industry of monopoly rents. From the perspective of welfare economics, it is important to encourage the pursuit of Ricardian rents, which is promoted through specialization and exchange, and to discourage rent seeking, which facilitates monopoly rents through artificial barriers to trade, precisely because competitors elsewhere have a comparative advantage in the particular industry.

Of course not all monopoly rents arise through legal protections. In industries with very high start up costs, for example utilities, declining average costs tend to drive out competition in favor of a single dominant firm.[234] In addition, the mere presence of a scarce resource in a given location can give those who control that resource substantial market power. Thus, a state that has a peculiar but highly valued export resource, say coal, can extract monopoly rents coal by engaging in a monopolistic pricing strategy. And this strategy will confer those rents without any obvious rent seeking, for example that associated with a narrow constituency seeking to derive benefits from a widely dispersed constituency. This can prove significant for purposes of the dormant commerce clause doctrine because if the doctrine's concern is that condoning state rent seeking encourages retaliation by those adversely affected in other states, thus threatening to produce a regime of mutual defection in a standard prisoners' dilemma, then one can appreciate why monopolistic pricing strategies for scarce export commodities are presumed beyond the reach of the dormant commerce clause. Simply put, this sort of rent seeking is unlikely to provoke a retaliatory response. The opportunities for states seeking to engage in marginal revenue pricing with respect to scarce export resources is limited by happenstance and those who possess such opportunities over one export commodity are unlikely to be those harmed by the efforts of other states who can pursue the same strategy over other export commodities. As a result, we might imagine the Supreme Court declining to treat such pricing strategies as

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[234]This is the traditional justification for regulating utilities. For a more detailed discussion, see WILLIAM J. BAUMOL & ALAN S. BLINDER, ECONOMICS: ECONOMICS: PRINCIPLES AND POLICIES 579-80 (5th ed. 1979); STEARNS, *supra* note 213, at 112-15.

candidates for strict dormant commerce clause scrutiny. This is so *even though* such a facially neutral regime, one that clearly burdens commerce, is economically motivated. So viewed, the export taxation exception fits nicely with the prisoners' dilemma account of the dormant commerce clause. Let us now contrast economic rents resulting from scarce export resources that are secured through monopolistic strategies with the more common forms of legislative rent seeking.

In what is certainly among the most important articles in the field of public choice, Gordon Tullock challenged the then-prevailing conventional wisdom among welfare economists that the principal problem with monopolistic pricing is the welfare loss triangle.[235] Instead, Tullock posited that the more problematic welfare loss was associated with incentives by special interests to secure the benefits of monopoly rents through the legislative process. Specifically, it is rational for special interests to invest up to the anticipated value of a monopoly rent in lobbying efforts to secure the rent. So viewed, the danger of rent seeking is not only the welfare loss triangle, however difficult to measure that might be, but also the further deadweight loss of attempting to secure monopoly rents through legislative means. Thus, organized groups will attempt to secure the benefits associated with actual market power (as in the coal hypothetical) through artificial legislative protection against out-of-state competition. And of course, many cases that we have already seen fit this paradigm. Thus, a tax-and-rebate scheme in which all sales of milk are taxed, but the funds are then distributed to in-state producers, is a classic case in which the industry receives the benefit of a differential tax against the interest of out-of-state purchases, thus conferring a rent. Similarly, a law that prevents an out-of-state competitor from advertising its superior product in state operates as a legislatively conferred rent.

At this point, we have defined four different kinds of rent: monopoly rent, Ricardian rent, legislative rents, and of course, appropriable quasi rents. As stated previously, the dormant commerce clause doctrine is concerned with those forms of state rent seeking that encourage defection either in a prisoners' dilemma or multiple Nash equilibrium game. We have already explored the manner in which various forms of rent seeking does or does not encourage mutual defection in a standard prisoners' dilemma. We must now consider how state efforts to secure quasi rents can thwart other states in their efforts to benefit from Nash equilibrium strategies that facilitate the flow of commerce. This will further allow us to determine the nature of rents that are of particular concern to the dormant commerce clause. The opportunities for states to appropriate quasi rents takes a somewhat different form than the same opportunities among parties to a contract. For example, states do not formally enter into binary or multilateral agreements with other states, at least without prior Congressional approval,[236] and when they do, any resulting rents, because they would be subject to that approval, would not be challenged under the dormant commerce clause. The concept of appropriable quasi rents must therefore be recast to allow us to identify the nature of the underlying rent seeking in multiple Nash equilibrium games between and among states that implicate the dormant commerce clause doctrine. The analysis requires a brief exploration of the closely related economic concept of transactions costs.

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[235] *See* Tullock, *supra* note 193.

[236] *See supra* note 201(quoting compacts clause).

a. Defining Transactions Costs

Like rent seeking, transactions costs is a ubiquitous term and one that is often used to express a range of meanings. As Stanley Fisher has noted: "Transactions costs have a well-deserved bad name as a theoretical device . . . because there is a suspicion that almost anything can be rationalized by invoking suitably specified transactions costs."[237] And as Oliver Williamson has stated: "[T]he concept wants for definition."[238] The pervasive interest in transactions costs, of course, dates back to Ronald Coase's early study on the firm,[239] and his later study on the problem of social cost.[240] In his first study, Coase posited that the firm is best understood as a nexus of contracts, which avoids many of the problems associated with long term relational contracting. And in the second, for which he won the Nobel prize in economics in 1991, Coase considered whether and when the assignment of property rights affects resource allocation. The Coase Theorem posits that in a world with zero transactions costs and perfect information, resources will flow to their most highly valued uses without regard to initial property endowments. While the article was widely read to suggest that transactions costs are generally irrelevant to resource allocation, Coase's point was just the opposite. His essential insight was that because transactions are most often costly, it is important for the legal regime to mimic the parties' ex ante expectations concerning the allocation of property rights, lest transactions costs themselves inhibit the efficient flow of resources to their most highly valued uses. For our immediate purposes, it is important to begin with the zero transactions costs assumption. We do not do this because transactions costs are zero, but rather because the model is intended to inform us as to the nature of state law strategies, taking the form of transactions costs, that can inhibit a benign Nash equilibrium regime among states that facilitates the flow of resources to their most highly valued uses within the context of interstate commerce.

a. Empty Core Bargaining as a Transactions Cost

We can illustrate Coase's essential insight by imagining a world with two entities, a laundry and a factory that pollutes into a river to the detriment of the laundry.[241] Assume that the factory is worth $11,000, but that as a result of its pollution, it reduces the value of the laundry from a potential of $40,000 to $24,000. Further assume that for the laundry to receive the maximum benefit of its output, and thus to be valued at $40,000, it must close the polluting

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[237]Stanley Fischer, *Long-Term Contracting, Sticky Prices, and Monetary Policy: Comment*, 3 J. MONETARY ECON. 317 (1977).

[238]Williamson, *supra* note 200, at 233.

[239]*See* Coase, supra note 199.

[240]Ronald H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960); see also Compare Ronald H. Coase, *Notes on the Problem of Social Cost*, in R. H. COASE, THE FIRM, THE MARKET, AND THE LAW 157 (1988).

[241]The following hypothetical is adapted from Varouj A. Aivazian & Jeffrey L. Callen, *The Coase Theorem and the Empty Core*, 24 J.L. & Econ. 175 (1981). The hypothetical that follows is the actual version that appears in that article. For my earlier analysis of this article, see Stearns, *supra* note 72, at 1234-40.

factory down. In a world with zero transactions costs and in which the parties have perfect information, the factory will close and the laundry will operate. This result will be achieved regardless of whether the laundry holds the property right to prevent the factory from polluting or the factory holds the property right to pollute without regard to the harm to the laundry. If the factory has the right to pollute, the laundry will pay up to $16,000–the difference in its value with and without the factory polluting–to purchase that right from the factory. Because the factory is worth only $11,000 even with the right to pollute, it has an economic incentive to sell the pollution right to the laundry. If instead the laundry owns the right to prevent the factory from polluting, then the factory will not be able to justify purchasing from the laundry the right to pollute because the factory values that right at $11,000, which is $5000 less than the laundry values the contrary right.

In this simple story, resource allocation is indifferent to liability rules for one very good reason. We have assumed away all of the complexities that can plausibly inhibit the claimed efficient result. Of course we can readily envision any number of costs that might break the deal. For example, the factory owner might derive psychological satisfaction from keeping the factory open, the laundry might not know the relative value of the factory with and without pollution and might decline to invest in acquiring that necessary information, or the parties might simply not wish to deal with one another even if there is a potential financial gain from doing so. There are numerous costs that can inhibit any potentially fruitful deal, whether they are psychological or informational in origin. For now, let us simply follow Coase's lead and assume that these costs, or any other costs that could inhibit the transactions, are zero. In the original version of the laundry/factory hypothetical, Professors Aivazian and Callen demonstrated that in a world with no transactions costs and perfect information, empty core bargaining itself can prevent the flow of resources to their most highly valued uses.

To illustrate, we will now alter the facts to restore the original hypothetical. This time, assume that instead of one polluting factory operating to the detriment of the laundry, there are two, with a combined value of $11,000. Assume that operating alone, factory A is worth $3000 and factory B is worth $8000. As before, the laundry, C, is worth $24,000. Further assume that any combination of two will increase the value to the coalition members. If the factories merge, then they increase their output from $11,000 to $15,000 due to economies of scale. If factory A merges with the laundry, then that factory will close down and the merger will increase the value of the laundry from $24,000 to $31,000, leaving the value of factory B unaffected. If factory B merges with the laundry, factory B closes down and the merger will increase the value of the laundry from $24,000 to $36,000, leaving the value of factory A unaffected. And if both factories join a grand coalition with the factory, they both close down, increasing the value of the laundry from $24,000 to $40,000. For every coalition that includes the laundry, all of the value that the coalition produces results from the laundry operating alone and without the pollution that the other coalition member would have generated if it were not in the coalition. The resulting values of the possible coalitions are follows, where V means "value," the parenthetical includes the parties to the coalition, and the bracketed entries represent the amounts earned (in $1000 increments) within or outside the coalition:

V (A) [3] + V (B) [8] + V (C) [24] =$35,000

V (AB) [15] + V (C) [24] *or* V (AC) [31] + V (B) [8] *or* V (BC) [36] + V (A) [3] =39,000

V (ABC)=$40,000

In this hypothetical, a stable outcome arises if the laundry possesses the property right to

prevent the factories from polluting. The combined value of the two firms, now $15,000, is insufficient to bribe the factory, which increases in value by $16,000 if the firms close down, into allowing them to operate. But if instead there is no pollution liability rule, meaning that the factories are free to pollute, then there is no stable outcome. To illustrate, assume that we begin with two-party coalition, for example (AB), and that they evenly divide their superadditive profits from $11,000 to $15,000, such that A now earns $5000 (from $3000), B now earns $10,000 (from $8000), and the excluded C earns $24,000. C can now lure A away and offer to split evenly the additional $2000 that A and C can collectively earn in the superior (AC) coalition. In this superior coalition, A earns $6000 (from $5000), B earns $8000, and C earns $25,000 (from $24,000). B, who is now excluded can approach C and offer to split the $3000 superadditive profits that would arise in a superior (BC) coalition. In this superior coalition, A earns $3000, B earns $9500 (from $8000), and C earns $26,500 (from $25,000). And now A can approach B, yet again, and offer to split the superadditive profits of $15,000, which exceed their combined earnings in the (BC) coalition by $2500. We have now come full circle, from (AB) to (CA) to (BC) to (AB). In each round, the defector and new coalition member have achieved superadditive gains.[242] The same anomaly arises if we instead began with the grand (ABC) coalition, in which the three members divide evenly the $5000 superadditive profits, at $1666 each. A now earns $4666, B earns $9666, and C earns $25,666. A and B can now evenly divide difference between their superadditive profits of $15,000 and their present combined earnings of $14,332, placing them in a superior coalition. At this point, we are at the initial state (albeit with different initial payoffs) from which the cycle began in the two-party coalition game.[243]

Empty core bargaining games like this one are easy to criticize because they abstract from the prevalent rules that tend to produce stable outcomes in most real world situations. But the criticism misses the point. The games are helpful in analyzing why such stabilizing rules emerge in the first place, even though their effect is often to produce a result that is normatively inferior, given the payoffs, to some conceivable alternative. For our purposes, the critical point to glean from the empty core game is that it produces an opportunity for one or more entities (here a laundry or two firms) to secure the functionally equivalent of appropriable quasi rents that arise in a contract setting. From an ex ante perspective, most would agree that given the values attached in the hypothetical to each economic activity and holding all else constant, the optimal

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[242]In response to this hypothetical, Ronald Coase leveled two arguments. First, he observed that the regime envisioned is peculiar in that it anticipates multiple coalitions that could be entered into and breached at will. Second, Coase claimed that the hypothetical was trivial because if the parties consistently divided the superadditive gains evenly, they would discover that the payoffs asymptotically approach the highest amount as they move toward the grand coalition. *See* Ronald H. Coase, *The Coase Theorem and the Empty Core: A Comment*, 24 J. L. & ECON. 183 (1981). On both grounds Coase is correct. But the first criticism is founded on something of a trick. While a contract damages rule would deplete any gains from defection in favor of a superior coalition, a contract damages rule is not a rule establishing an initial property right, which, along with zero transactions costs and perfect information, is all that the Coase theorem posits is necessary for efficient resource allocation. As for the second argument, nothing in the Coase theorem dictates how superadditive gains are to be allocated, and thus the even division assumption again derives from outside the Coase theorem itself. More importantly, whether the hypothetical is significant on its facts, it does demonstrate an outcome that in a zero transactions cost world does not ensure the predicted result of the Coase theorem.

[243]For a more detailed presentation that walks through each step, see Stearns, *supra* note 72, at 1234-40.

result would be to close the factories in favor of the laundry, and to divide the surplus evenly among the players. Indeed, many legal rules follow such a default pattern when one could formalize an empty core bargaining game.[244] And yet, despite the apparent appeal that such a solution holds, we do see shadows of empty core bargaining in the real world.

While most situations in which one can infer possible empty core payoffs produce some actual, meaning noncyclical, outcome, sophisticated economic actors understand the genuine dangers that opportunities for strategic bargaining over this form of appropriable quasi rents can produce. Thus, it is well known that a company, like Disney Corporation, seeking to acquire a large piece of land would be ill advised to announce the superadditivity in advance, and offer up a reasonable portion for affected landowners to share evenly if they all agreed to sell. Disney understands that one or more potential sellers will likely try to extract a disproportionate share of the rent by "holding out" for a superior deal, even if the effect is to thwart the entire set of transactions. After all, a landowner in the middle of a potential theme park has the potential to seek to appropriate unto himself a hugely disproportionate amount of the available rent that would arise if all the land were converted into the more highly valued use.[245]

Legal scholars have recognized that individual states can "hold out" in the production of a public good by defecting from what I have presented in this article as a benign pro-commerce solution to a multiple Nash equilibrium game.[246] But unlike in the standard hold out game, those seeking compliance–namely those states whose Nash equilibrium, pro-commerce strategy is thwarted by the hold out state's defection–have no direct means of paying off the defecting state to secure compliance in the provision of the public good. Instead, the payoff to the defecting state comes not from a hopeful payoff from the threat of defection as in the Disney hypothetical, but rather comes somehow from the defection itself.[247] For this reason, it is helpful to recast the

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[244]This includes inheritance laws. For a more detailed illustration that draws upon social choice theory, see, see STEARNS, *supra* note 145, at 54-58.

[245]When this sort of event arises, the parties do not cycle into oblivion, but the result and payoffs reached are "arbitrary" in the sense that some other set of ultimate arrangements could have provided a superior benefit to some alternative coalition. It is possible to hold out too long. Thus, when a developer seeks to acquire a large plot with the intent to develop the land into a substantially more highly valued use, the final hold out or group of holdouts are roughly in a game of chicken with the corporation. If the holdout fails to jump off short of the cliff, thus accepting a credible final bid, the prospective buyer might elect to build around hold outs. *See also* David McGowan, *Innovation, Uncertainty, and Stability in Anitrust Law*, 16 BERKELEY TECH. L.J. 729 (2001) (noting connection between hold out and chicken games in intellectual property context involving technical innovations). For a recent illustration of the merger of these two games, see Tom Gorman, *When residents won't sell, mogul builds around them,* BALTIMORE SUN 6A (November 29, 2002) (quoting one of the final hold outs to of Las Vegas resort development as stating "[i]f Wynn [the developer] continues at this . . . pace, he'll make these homes uninhabitable.").

[246]Professors Epstein and Burk do not cast their analyses in terms of a multiple Nash equilibrium game. *See supra* note 204, and cites therein.

[247]Unlike the holdout game described *supra* note 239, the interstate commerce game does not threaten to become a game of chicken. In the multiple Nash equiilibrium game that arises in the context of interstate commerce, the defecting state is not motivated to discourage the other states from adopting a contrary strategy; rather, the defecting state directly benefits from the fact that other states have adopted a common strategy from which it can

defecting state's effort from holding out in the provision of a multistate public good to rent seeking.

Appropriable quasi rents, including those that become available as a result of empty core bargaining games, can obstruct otherwise beneficial transactions. Recall the Coase theorem: In a world with zero transactions costs and perfect information, resource allocation is indifferent to liability rules. In the actual Avazian and Callen hypothetical, the more highly valued use of the resources would come about if the party who valued the property right more highly–the laundry–held the right in the first instance. But if the less valued polluting firms instead owned held the right, then the Coase theorem result is no longer guaranteed. One possible theoretical escape hatch is to include as a transactions cost the very form of appropriable quasi rents, namely empty core bargaining, that threatened to obstruct efforts to bring about the desired result. While this "rescues" the Coase theorem, it does so through a seemingly dissatisfying ploy. Including as a transactions cost whatever prevents the desired Coasian result from being realized threatens to turn the theorem into a tautology. And it is noteworthy that in his own response to the Avazian and Callen hypothetical, Coase did not take this approach.

Even so, economists have recognized appropriable quasi rents as a transactions cost.[248] Whether or not this is satisfying in light of the Coase Theorem, it is a useful characterization for our purposes. If we accept the proposition that one of the objects of the commerce clause is to facilitate a common Nash equilibrium strategy among the states that facilitates commerce, at least unless Congress says otherwise, then the question arises what prevents Congress and the states from achieving the desired pro-commerce result. And here, appropriable quasi rents–generalized to encompass empty core bargaining games–reveals a critical cost that can impede "transactions" among states, left to their own devices, to achieve that preferred regime. That is because the relationships between and among the states themselves, like the relationship between contracting parties, give rise to a divergence between ex ante and ex post expectations.

a. Recasting the Multiple Nash Equilibrium Game in Terms of Transactions Costs

To complete the model it is important to add one more layer to the preceding analysis. In the above hypothetical, the cycling problem arose when we split a single polluting firm into two, creating three businesses for which every two or three party coalition produced a superadditivity. We will now consider a variant of the driving game previously introduced.[249] We will begin with two players, this time the states themselves, rather than individuals within a state, and then introduce a third. As before, the two options are driving on the right or the left. With two states and two driving options, the matrix presented in Table 6,[250] characterizes the choice of regime as with two drivers in a state. If we assume that vehicles are designed to drive on one side of the road or the other–for example, left steering wheels for driving on the right as in the United States or right steering wheels for driving on the left as in Britain–then states seeking to facilitate the flow of interstate commerce will have an incentive to adopt the same regime, whether it is (right,

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defect.

[248]*See supra* notes 199, 200, 227, and 228, and cites therein.

[249]*See supra* at 6.

[250]*See supra* at 64.

right) or (left, left). Conversely, an individual state can improve its position by moving from either of the two available mixed strategy equilibria–(right, left) or (left, right)–to a Nash equilibrium outcome.

Even if the states desire such a benign outcome, it is by no means guaranteed. Thus, if we assume that the states would prefer to share a common regime, and if we further assume that they were unaware of the other states' choices at the time that they had to select their own, then the result would be a mixed strategy equilibrium. This means that each would guess at what the others will choose, with a 50% chance of success. While the individual states are attempting to secure the benefit of a Nash equilibrium strategy, the collective outcome might not be a Nash equilibrium.[251] If the decisions are not made simultaneously, as will most often be the case, this problem is likely to be avoided. Path dependence implies that returns rise when others follow the lead of the initial mover. In this context, if one or a group of states elects driving on the right, it is likely that others will follow suit precisely to secure the benefits flowing from a common regime. In this situation, there is little risk of a mixed strategy equilibrium, at least assuming that the incentive is to benefit from a common traffic regime.

But now imagine that a group of states has succeeded in adopting a common driving regime. Further imagine that a single state, or city, for example Manhattan, would like to reduce its own traffic. One might imagine a proposal to limit driving to in-city taxicabs or limousines. The city might approach this in any number of ways, for example, by passing a law that prevents anyone with a license that is not issued with a Manhattan address from driving in the city, or prohibiting all cars other than registered Manhattan taxicabs. It seems quite probable that such laws would violate the dormant commerce clause, and perhaps also the Article IV privileges and immunities clause. Now imagine that the city chooses a different means of achieving the same objective. The city will permit all drivers with valid licenses to drive through Manhattan, but whereas the rest of the nation drives on the right side of the road in vehicles with steering wheels on the left, driving in Manhattan will be on the left side of the road with steering wheels on the right. Assuming that such a regime were legal, only those with a very strong incentive to invest in a conforming vehicle would do so. Local taxi drivers and wealthy urban residents might fit this description, but few others would.

Notice that by introducing the left side driving regime, Manhattan is not rejecting the chosen solution to the multiple Nash equilibrium game because the wrong Nash outcome was selected. This is most easily illustrated by imagining that the rest of the nation had instead followed the British driving rule. In that case, Manhattan would have elected the United States driving rule. The whole point from the perspective of the state or city passing the defecting law is to have a rule that is *contrary* to the prevalent regime among other states. Also notice that the benefit accruing to Manhattan could not have arisen but for the dominant pro-commerce regime of other states.[252] And finally, the rent that Manhattan achieves imposes a direct cost on other states, which have chosen to facilitate a common regime that promotes the flow of traffic throughout the nation. But Manhattan's goal is not to have the surrounding states purchase its submission, as in the standard hold out game. Instead, the Manhattan driving rule is motivated by the desire to divert traffic around Manhattan, and thus to secure whatever "rent" derives from the

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[251] *See* BAIRD, ET AL, *supra* note 205, at 22.

[252] Such a rent would not be available, for example, if the sum of the other states' strategies produced a mixed equilibrium, rather than one of the two preferred Nash equilibria.

very fact of enacting the contrary rule. Because that rent arises only as a result of the relationships established through Nash equilibrium, pro-commerce laws of other states, Manhattan's effort can be fairly characterized as an effort to appropriate quasi rents made available through the Nash equilibrium strategies of affected states.[253]

The game theoretical account of the dormant commerce clause doctrine not only provides a more robust account of the various cases and doctrines, but also, it helps to explain several peculiar features of the doctrine. Among those features is the default nature of the resulting constitutional doctrine, which Congress is at liberty to change through ordinary legislative means. The default nature of the dormant commerce clause doctrine is most easily understood by recognizing that defection from a Nash equilibrium strategy represents a special kind of transactions cost impediment to the flow of interstate commerce that the Court can reduce or eliminate by striking a challenged law under its dormant commerce clause doctrine, subject to the caveat that the resulting regime might prove inferior to another potential Nash outcome over time. To illustrate, imagine that driving regimes could be altered costlessly. In this zero transactions cost world, the Manhattan rule would introduce a cycle. The rest of the states start with right driving and Manhattan defects to left driving. Because the other states care more about the benefits of coordination than about whether driving is left or right, they follow suit and switch to left driving. But since Manhatttan also does not care about which side its residents drive on, provided it is contrary to the rest of the nation (or at least the Northeast corridor), it then switches to right driving. Now the other states switch back, and on and on it goes.

b. Disrupting Path-Induced Equilibrium (or Network Externalities) as a Transactions Cost

Of course the transactions costs of switching driving infrastructures and investing in new vehicles make the hypothetical cycle seem implausible, perhaps even absurd. To complete the model, therefore, we must introduce more formally the concept of path dependence. Once a state or group of states selects from one of two or more potential Nash equilibria, the decisions of other states to follow suit creates increasing returns to all states–those that previously selected the initial strategy and those that followed suit–relative to a mixed strategy equilibrium. While economists usually assume that as the amount of any given activity increases, marginal returns are diminishing, when activities are path dependent, meaning that the activities produce positive network externalities, the opposite assumption holds.[254] Path dependence has been applied to a variety of subject matters, including such discrete goods as typewriter keyboards,[255] and

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[253]The difficulty of allowing a single state or city to thwart a Nash equilibrium outcome can be further illustrated by imagining that the driving regimes in all states were regulated by Congress. We could readily imagine Congress selecting a right or left driving regime. But it seems implausible to imagine Congress electing a mixed strategy equilibrium regime.

[254]For discussions of path dependence and its relationship to legally created network externalities, see Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1996) (applying principles of path dependence to challenge various conventional wisdoms about the presumed efficiency of American corporate and bankruptcy structures). For a useful general discussion of path dependence and network externalities, see S.J. Liebowitz and Steven E. Margolis, *Path Dependence, Lock-In, and History*, 11 J. LAW ECON. & ORG. 205 (1995) (describing limited conditions under which remediable path dependence can occur).

[255]S.J. Liebowitz and Steven E. Margolis, *The Fable of the Keys*, 23 J. LAW & ECON. 1 (1990) (documenting counter-evidence against claimed path dependence of selection of QWERTY over DVORAK

VCRs,[256] political[257] and economic systems,[258] and various legal doctrines, including stare decisis.[259] In each case, the coordination of the activity produces positive gains for others who benefit from their common use. It is the fact of coordination (whether express or tacit) that increases returns to those who elect to follow the lead strategy.

Because of the high transactions costs of shifting regimes from one set of pro-commerce regimes to another, path dependence characterizes the choice among states of common legal regimes that facilitate the flow of commerce. So viewed, the harm from a single state's defection from a commerce-based multiple Nash equilibrium game can be now be recast in terms of undermining the superior gains associated with path-induced increasing returns resulting from positive network externalities. These two consistent characterizations help to underscore the nature of the rent seeking at issue in these cases. The facts of *Kassel* and *Bibb*, for example, fairly resemble efforts by defecting states secure benefits simply by thwarting a pro-commerce Nash equilibrium outcome that is dominant in the surrounding states. While all states would benefit from a common, Nash equilibrium outcome, a defecting state can appropriate a peculiar rent by deliberately thwarting that strategy and thus undermining the gains to other states from following a Nash regime. The likely benefit in these cases is diverting traffic around the state and reducing the maintenance costs associated with the flow of truck-based interstate commerce. The benefit is most pronounced in *Kassel*, a case in which the governor expressly acknowledged these objectives.

While the Court uses the dormant commerce clause to prevent mutual defection in a prisoners' dilemma game and to restore a benign multiple Nash equilibrium game, the Court does not use the commerce clause to eliminate all forms of rent seeking. Some rent seeking distributes wealth from diffuse to organized groups, but does so at the expense of interests in state, as well as at the expense of private interest out of state. Because such rent seeking, which provides special interests with the equivalent of economic rents, has such a distributional effect within the state, we can understand the Court's disinclination to direct the dormant commerce clause at rent seeking as such. First, there are political forces within the state to counteract such rent seeking, especially since the burdens are at least as great within as outside the state. Second,

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typewriter keyboard); Paul A. David, *CLIO and the Economics of QWERTY*, 75 AM. ECON. REV. 332 (1985) (linking selection of claimed inferior QWERTY typewrite keyboard over claimed superior DVORAK keyboard to path dependence).

[256]W. Brian Arthur, *Competing Technologies, Increasing Returns, and Lock-In by Historical Events*, 99 ECON. J. 116 (1989) (modeling conditions giving rise to path dependence); W. Brian Arthur, *Positive Feedbacks in the Economy*, 262 SCI. AM. 92 (1990) (same)

[257]Paul Pierson, *Increasing Returns, Path Dependence, and the Study of Politics*, 94 AM. POL. SCI. REV. 251 (2000).

[258]DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990) (linking differential economic performance across wealthy and poor nations to path dependent effects of historical price differentials); Douglass C. North, *A Transaction Cost Theory of Politics*, 2 J. THEORETICAL ECON. 355 (1990) (same).

[259]*See* Maxwell L. Stearns, *Standing Back from the Forest: Justiciability and Social Choice*, 83 CAL. L. REV. 1309 (1995) (demonstrating that stare decisis is a cycle-breaking rule that renders the evolution of legal doctrine path dependent and that standing operates as a constraint that raises the cost to private litigants of seeking to favorably manipulate the path of case decisions); Maxwell L. Stearns, *Standing and Social Choice: Historical Evidence*, 144 U. PA. L. REV. 309 (1995) (testing social choice theory of standing against historical and case evidence).

to the extent that these forces are overcome by the stronger lobbying incentives of special interests, the power of individuals to vote with their feet imposes additional discipline.[260] And finally, even if this proves inadequate, the fact remains that the commerce clause has not been–and in my view should not be–used as a subterfuge for economic substantive due process.[261] The commerce clause in its dormant capacity is directed at laws that affect commerce. While the other two categories–mutual defection in a prisoners' dilemma and restoring a multiple Nash equilibrium game–fit this description, intra-state distributional legislative rent seeking does not.

3. Summary

We have now completed the formal model, and are ready to revisit the cases set out in part II. Before doing so, I will briefly summarize the three relevant case categories that emerge from the foregoing analysis. As we will see in Part IV, these case categories can best be viewed as endpoints on a spectrum. The task then is to identify those factors that can be used to place cases closer to the most relevant endpoint.

1. *State Laws that Risk Promoting a Regime of Mutual Defection:* While the per se rule of invalidity has largely eliminated the most obvious state law efforts to secure legislative rents in a manner that is likely to invite retaliation by other states and thus a regime of mutual defection, state legislatures are sufficiently sophisticated that they are able to devise other methods of achieving the same objectives. The prisoners' dilemma analysis provides a means of assessing these types of state laws and of understanding the Court's use of strict scrutiny to assess those categories of laws that are likely substitutes for blunt regulations that would have been subject to the per se rule. Even in the context of cases in which a prisoners' dilemma analysis applies, however, anomalies remain. In the waste cases, for example, the Court's refusal to allow statutes that discriminate against waste in commerce threatens to transform, rather than to eliminate, the prisoners' dilemma. And in the reciprocity cases, the Court has eliminated a mechanism through which states unilaterally discourage defection by partnering states. Third, and most importantly, the prisoners' dilemma fails to account for those cases in which states secure rents at the expense of pro-commerce regimes of other states and in which other states are seeking to act in concert, rather than to defect. In short, the prisoners' dilemma provides a useful starting point in thinking about the dormant commerce clause, but falls short of providing a comprehensive model.

2. *States Laws that Disrupt Benign Multiple Nash Equilibrium Games:* The most controversial dormant commerce clause cases involve statutes that are facially neutral and that

[260] *See* Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956) (positing that ability of local residents to vote with their feet disciplines governmental abuses of taxation and expenditures).

[261] While a normative defense of this proposition is beyond the scope of this article, which is motivated by the need for a positive account of existing doctrine, suffice to say that in general the same structural justifications for allowing in-state political processes to counter inefficient rent seeking laws apply regardless of whether the failure of these processes to prevent undesirable rent seeking legislation results in a substantive due process or a dormant commerce clause challenge. Even if one one rejects this process-based argument, however, that does not undermine my argument that reliance upon the commerce clause is improper to challenge what is in effect a claim resting on principles of economic substantive due process. My own view remains that it is better to debate the merits of economic substantive due process in the context of the due process clause than in the context of the commerce clause, which is targeted to the very specific concern of facilitating political union among states and not to demanding efficient state laws.

are linked to a purpose that the Court admits is legitimate. It is for that reason that in category 4, within the framework in Part II, the Court has gone back and forth on the appropriate test, variously suggesting that the balancing test or the rational basis test should apply. And yet, while the Court does not apply strict scrutiny in this context, it has struck down laws alleged to burden commerce that fit this paradigm. The game theoretical model provides a sound normative justification for the Court's decisions that strike down state statutes grounded in admittedly legitimate concerns over highway safety if those laws appear to fit the paradigm of thwarting what would otherwise have been a simple multiple Nash equilibrium game by introducing a third, mixed-strategy, regime, the effect of which is not truly to advance safety, but rather to secure an appropriable quasi rent at the expense of the pro-commerce regimes or dominant practices of other states. So viewed, these cases reveal that rather that operating on the periphery of the Court's dormant commerce clause jurisprudence, as reflected in the Court's ambivalence over the choice of test, they represent a second core value of this doctrine. These cases further underscore the importance of maintaining a default regime in this area to allow Congress, should it determine that the dominant outcome selected by the early moving states, which may well be the product of path dependence, is inferior to an alternative Nash outcome (as distinguished from a mixed outcome).

3. *Intra-State Legislative Rent Seeking*: Because both of the two preceding categories lie at the core of the Court's dormant commerce clause jurisprudence, the Court should apply an opposite presumption to those laws that fall into neither of those categories. The market participant cases and the export taxation cases fit this description. While market participant cases involve laws that discriminate on their face against commerce and that are economically motivated, they operate in a manner that is more like a subsidy that distributes wealth from diffuse to organized groups within the state. The laws are rent seeking, and they burden commerce in the sense that all rent seeking laws produce inefficiencies, but the burden falls at least as heavily on the enacting state as on any outside interests. As a result, if sustained, these laws are not likely to provoke a retaliatory response or a regime of mutual defection. In addition, these laws do not operate at the expense of Nash equilibrium, pro-commerce regimes of other states. In fact, they do not affect the decisions of other states to pursue or decline to pursue the same sorts of schemes on their own. Because market participant cases fall into neither core category, we can appreciate the Court's decision to carve out a doctrinal exception involving the state as market participant.

A similar analysis applies to the export taxation doctrine. In this context, the opportunities of other states to retaliate is limited because of the random allocation among states of scarce resources that might be of value to the state that initially enacted the burdensome law. In addition, while the law "burdens commerce" by imposing a heavy tax on foreign purchasers, it does not burden commerce in the sense of undermining coordinated pro-commerce regimes of other states. The burden here falls on private parties, not states, and is likely to have a limited effect in encouraging states to respond.

While the market participant cases and the export taxation doctrine are often viewed as enigmatic, the game theoretical model reveals that they fall outside the categories of prisoners' dilemma or multiple Nash equilibrium games. Of course the cases will not always be as neat as the case paradigms in the model. As stated above, the model is intended to reveal meaningful end points on two spectrums along which these other cases can be graded.

We are now ready to revisit the cases and doctrines introduced in part II in light of the game theoretical model.

IV. Applying the Game Theoretical Model: The Dormant Commerce Clause Cases Revisited

In part II, we reviewed the cases from the dormant commerce clause, the market participant exception, the export taxation doctrine, and the Article IV privileges and immunities doctrine. The presentation was motivated by the desire to set out the principal doctrinal categories and then to expose the inconsistencies within those categories. Applying the model developed in the prior part, we will now start at the back end, explaining away the most anomalous categories–the market participant doctrine and export taxation–and then proceed to the dormant commerce cases themselves. In doing so, we will also articulate a vision of the dormant commerce clause and its related doctrines that provides a sounder normative foundation than its critics would have us believe.

A. The Exceptions that Help Define the Rule: Market Participation, Export Taxation, and Article IV Privileges and Immunities

While most analyses of the dormant commerce clause except the market participant and export taxation doctrines, the game theoretical analysis provides both a positive explanation and a normative foundation for their different treatment. It also allows us to understand the Article IV privileges and immunities doctrine, which functions as an exception to the market participant doctrine, as more than a clever, or silly, exercise in pleading. That said, I do not contend that all of these cases should receive the level of scrutiny attached under the various doctrines. I continue to find the market participant cases problematic in a particular respect. But the important point for our purposes is that my objection to those cases is not grounded in concerns that relate to the commerce clause.

The market participant doctrine was articulated in a trilogy of cases: *Hughes v. Alexandria Scrap Corp*.,[262] *Reeves, Inc. v. Stake*,[263] and *White v. Massachusetts Council of Construction Employers, Inc.*[264] In the first two cases, the Court exempted the challenged statute from its ordinary dormant commerce clause scrutiny, asserting that when the state operates in an entrepreneurial capacity, the state can select with whom it deals. In the third case, *White*, it extended the principle to allow the state to impose downstream conditions upon its contractors, suggesting that the state not only can choose with whom to deal, but also on what terms. The more recent decision, *South-Central Timber Development v. Wunnicke*,[265] appears to cut back on the *White* extension by suggesting that if the out-of-privity contract requirement operates in a different market from that in which the contract takes place, then the state is beyond the proper bounds of its entrepreneurial functions. The effect is to then reintroduce ordinary dormant commerce clause scrutiny. As applied to the case facts, the result was to subject Alaska's in-state processing requirement for its 49 million board feet of lumber to the virtual per se rule of invalidity. Finally, in a case that is factually closest to *White, United Building & Construction*

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[262] 426 U.S. 794 (1976).
[263] 447 U.S. 429 (1980).
[264] 460 U.S. 204 (1983).
[265] 467 U.S. 82 (1984).

Trades Council v. Camden,[266] the Court remanded a case involving a 40% municipal employment requirement for Camden contractors and subcontractors for findings on whether it met the stringent scrutiny imposed under the Article IV privileges and immunities clause.

The initial trilogy of market participant cases have been criticized on the ground that they sustain laws that expressly discriminate in commerce based solely on the fact that the discrimination takes a different form. The game theoretical analysis, however, provides a sound normative basis for their separate treatment. These cases each involve a fairly simple in-state rent seeking story, in which the entrepreneurial activity operates as an effective subsidy to an identifiable in-state interest, and does so in a manner that operates to the detriment of a readily identifiable, albeit diffuse, group of in-state taxpayers. Thus, in *Hughes*, the state elected to subsidize those who traffic in junked cars within Maryland, at the expense of those within the state who will help to defray the costs of the state's entrepreneurial efforts, but who will not receive the benefit. While those who traffic in junked cars out of state would prefer the opportunity to receive the benefit of the more favorable terms in Maryland, the state's decision to exclude them is unlikely to provoke any retaliatory scheme that results in a regime of mutual defection. Simply put, the scheme redistributes wealth from one group of Maryland residents to another, and if other states seek to engage in a similar scheme of redistribution, they are free to do so. This is not a case that is aptly characterized by an interstate prisoners' dilemma. The scheme does not create wealth for an in-state economic interest at the expense of some coordinated scheme among other states. Nor does it involve a multiple Nash equilibrium game in which a defecting states is attempting to secure quasi rents made available only as a consequence of other states' pro-commerce strategies. Again, the effect of the scheme is to redistribute wealth through a legislative conferral of rent within Maryland. Such a policy might be unwise, but one of the benefits of a federalist scheme–captured in the Tiebout model[267]–is that it might well be meritorious at the federal level to leave such policy decisions, however unwise they might be, to the states.[268]

The more difficult task is to explain the exceptions to the market participant doctrine itself, especially given the striking similarities between *White* and *Camden*. In *White*, the Court sustained a 50% municipal employment requirement against a dormant commerce clause challenge, applying the market participant doctrine. And in *Camden*, the Court remanded for additional findings on whether a 40% municipal employment requirement violated the Article IV privileges and immunities clause. The reconciliation does not grow out of the prisoners' dilemma and Nash equilibrium analyses, at least directly. These games reveal the conditions under which the Court presumes the dormant commerce clause doctrine inapplicable to in-state rent seeking that takes the form of state entrepreneurial efforts. It does not suggest anything else about the soundness or constitutionality of such schemes. While an analysis of the purposes underlying Article IV privileges and immunities is beyond the scope of this article, suffice to say that the clause expresses concern for the manner in which a home state treats a citizen of a foreign state when that foreign state citizen is in the home state. It is certainly a credible construction of this

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[266]465 U.S. 208 (1984)

[267]*See* Tiebout, *supra* note 257; ALBERT HIRSCHMAN, EXIT, VOICE AND LOYALTY (1970) (positing that while Tiebout model might understate difficulty of relocation as disciplining technique, voice provides more powerful discipline at state and local than at national level).

[268]A similar analysis can be used to characterize the *Reeves*.

clause to assert that employment is among the privileges that a state cannot confer upon its own citizens but deny to the citizens of other states, especially in a context that involves construction, as opposed, for example, to state or local governance.[269]

The *Wunnicke* exception remains problematic. In *Wunnicke*, the Court rejected the application of the market participant doctrine, which itself is an exception to the dormant commerce clause doctrine, by importing a quasi-antitrust analysis to create a further doctrinal exception that restores dormant commerce clause scrutiny. The result, as then-Associate Justice Rehnquist observed in dissent, appears dissatisfying because it provides the purchaser with a clear windfall, at least if we make the seemingly reasonable assumption that the contract price capitalized any additional costs that the purchaser was required to bear as a result of the in-state processing requirement. If that assumption holds, then the effect of the requirement is to offset in state contract revenues (benefitting Alaskans generally) the governmentally conferred rents paid to the processing industry. This is classic in-state rent seeking that is unlikely to engender any reciprocal efforts within other states and that does not undermine the Nash equilibrium, pro-commerce regimes of other states. Therefore the law does not undermine any public interest readily identified with the dormant commerce clause. Moreover, because the case likely produced a windfall, applying the market participant doctrine would not likely have adversely affected any significant private interests. Perhaps the fact that the buyer was foreign, and the difficulty in fitting the case facts into the confines of the seemingly more applicable import-export clause,[270] explains the Court's disinclination to exempt the contract provision from scrutiny. Regardless, the purpose of the model is not to justify the outcome in every single case, but rather to explain the relationships between and among the doctrines under review.

Before proceeding to the dormant commerce clause cases themselves, it is important to consider *Montana Coal*, which the Court's treated as an export tax case, rather than as a dormant commerce clause case. The case fits the game theoretical model nicely. The peculiar factual circumstances that give rise to export tax opportunities are sufficiently rare that the law is unlikely to invite retaliation and thus a regime of mutual defection in a standard prisoners' dilemma. And the tax in question does not undermine any Nash equilibrium, pro-commerce strategies in other states.

While the case fits the model, it might remain disturbing to some readers. *Montana Coal* implicates the difficult question of how to determine the appropriate tax level assessed in one state when the burdens fall in significant part on those residing out of state. In the ordinary course, we presume that those who pay taxes receive some set of benefits, or largess, that correlates with the amount paid in. In *Montana Coal*, that is a difficult proposition to defend. Clearly, Montana understood that it was exporting a considerable portion of its tax burdens to nonresidents, and doing so based upon its market power with respect to an export good. Here there was no need for legislative rent seeking. Instead, the legislature taxed the good and filled

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[269]While this does not answer the objection that the clause speaks to states, rather than to municipalities within states, I am satisfied that the relative ease of an end run around the clause, as seen in the split-the-state hypothetical developed in *Fort Gratiot*, 504 U.S. 353, 361 (1992), *see supra* note 186, and the fact that the municipal scheme grew out of a facilitating state statute, are each sufficient to justify this doctrinal extension. But if I am wrong, this simply undermines the Court's application of the privileges and immunities doctrine, not its decision to apply that doctrine separately from the dormant commerce clause doctrine.

[270]*See supra* note 216, and cites therein.

the state's tax coffers with the proceeds, knowing that over some relevant range, demand for the coal was relatively inelastic. The Court's decision to decline to apply dormant commerce clause scrutiny, even though the case falls well within category 3 (facially neutral/financially motivated) in the part II presentation, can be attributed in part to the inability of other states to reciprocate. But there is one additional justification for the result, having more to do with institutional competence. While the facts of the *Montana Coal* care are extreme, if the Court applied ordinary dormant commerce clause principles, it would necessarily invite claims that rest upon tax laws that allegedly impose disproportionate obligations on nonresidents that are substantially closer to a seemingly appropriate line.

The difficulty here is not merely one of judicial burdens, but also one of judicial competence. Incidence analysis is extraordinarily difficult even for those with the requisite training, and it requires the person undertaking the analysis to undertake assumptions that are invariably contestable. The Court's decision to allow Montana, which had a scarce natural resource, to maximize its tax revenues by linking a seemingly disproportionate tax burden on exports is likely attributable in large part to the Court's own appreciation that the federal judiciary is ill suited to undertake the kind of analysis required if it were to open the federal courts up generally to such suits.

B. The Dormant Commerce Clause Cases Revisited

We have now seen how the game theoretical model distinguishes the most criticized exceptions to the Court's dormant commerce clause doctrine. We are now ready to return to the dormant commerce clause cases. We begin with cases that reveal the core values of the Court's dormant commerce clause jurisprudence and then consider cases that do not fall into the previously discussed doctrinal exceptions, but in which the Court has nonetheless applied more relaxed dormant commerce clause scrutiny. The analysis will conclude with two tables that replace the decision tree in Tables 3 and 4, and that place the combined set of doctrines along two normative dimensions that together summarize the game theoretical analysis of the dormant commerce clause doctrine.

1. The First Core Value: Inhibiting a Regime of Mutual Defection in a Standard Prisoners' Dilemma

a. *City of Philadelphia* Revisited

We will begin with *City of Philadelphia v. New Jersey*,[271] in which the Court struck down a New Jersey statute that limited waste intake from outside New Jersey. The Court articulated the per se rule of invalidity and the balancing test, but appears to have applied strict scrutiny. The state could have achieved its legitimate objective of prolonging the life of its landfills by limiting the intake of waste without regard to its point of origin. Thus, even though it had a sufficient justification for its law, it did not select an available waste neutral means.

In some respects, the challenged law represents a paradigm case of facial discrimination. The statute discriminates on its face, and one might imagine a regime in which other states reciprocate defection by enacting similar state-specific waste intake laws.[272] Rather than

[271] 437 U.S. 617 (1978).

[272] And notice that in this context the geographical proximity of the importing and exporting states makes the possibility of the threat of reciprocal defection, and of rewards for cooperative strategies, all the more plausible.

facilitating this regime of defection dominance, the Court struck down the law as inconsistent with the dormant commerce clause. The difficulty, however, is that the very decision to prevent New Jersey from providing its residents a waste outlet might not have the desired effect of promoting a free trade among states over waste intake. Instead, it might simply change the outlet for mutual defection in waste. In this prisoners' dilemma game, New Jersey joins other states in failing to approve waste disposal facilities, leaving those who generate the waste–whether in state or not–with no waste outlet. This problem has been noted,[273] and in the context of low level radioactive waste was the primary justification for federal legislation attempting to coerce states to provide outlets for waste. In that case, the Court struck down the challenged amendments applying the newly articulated anticommandeering doctrine.[274] While that case arose on the affirmative side of the commerce clause, the conceptual difficulty that Congress faced was by no means limited to low level radioactive waste. Thus, one could imagine a comparable waste management crisis confronting the nation–perhaps it has already–respecting ordinary solid and liquid waste.

If states respond to the inability to provide state-specific solutions by denying permits altogether, then the effect of the *New Jersey* ruling is not to prevent a prisoners' dilemma, but to push it into another form. The problem with the Court's ruling is that it creates a default rule that Congress has generally been unable to change. If states were required to grant permits to those who qualified, then the *New Jersey* solution would be entirely sound. It may well be that certain states have soil conditions that allow for Ricardian rents in processing solid and liquid waste. A regime that promotes the creation of waste facilities without regard to point of origin would encourage the pursuit if such economically beneficial rents. On the other hand, if the dormant commerce clause requires state neutrality in the provision of waste storage facilities, but is not coupled with any obligation to approve valid permit requests, *New Jersey* instead promotes the perverse result that Rehnquist feared in dissent.[275] And if Congress were to coerce permit approval subject to specified regulatory criteria, it would risk running afoul of the anticommandeering principal. At a minimum, the analysis thus highlights the need for the Court to consider more closely the two sides of its commerce clause jurisprudence. Perhaps the Court should be more willing to accommodate states in restricting waste based upon point of origin under the dormant commerce clause when the Court itself has applied its affirmative commerce clause jurisprudence to prevent Congress from devising solutions that might encourage states to continue providing waste outlet facilities either on a commerce neutral basis or by allowing the states to discriminate in commerce if the chosen method involves commandeering.

b. *West Lynn Creamery* Revisited and *Camps Newfound/Owatonna, Inc. v. Town of Harrison*

In *West Lynn Creamery, Inc. v. Healy*,[276] Justice Stevens rejected a state regime that combined two facially neutral measures–a tax scheme that applied equally to all milk sales and a rebate scheme benefitting only Massachusetts milk producers–on the ground that the combined scheme had the effect of removing those who would stand in the shoes of the adversely affected

[273]*See, e.g.,* McGreal, *supra* note 99.
[274]*See* New York v. United States, 505 U.S. 144 (1992).
[275]*See supra* note 99 (quoting Rehnquist dissent).
[276]512 U.S. 186 (1994).

out-of-state milk producers and who would therefore be inclined to oppose the tax and rebate scheme. In effect, the majority opinion recognized that while the per se rule of invalidity applied only to facially discriminatory measures, interest groups can cleverly devise facially neutral schemes that have the same aggregate effect. And as with the facially discriminatory scheme, at least some facially neutral measures are likely to promote a regime of mutual defection. Writing in dissent, Justice Rehnquist asserted that "[a]nalysis of interest group participation in the political process may serve many useful purposes, but serving as a basis for interpreting the commerce clause is not one of them."[277] In fact, while interest group analysis is not helpful in predicting particular case results, it is helpful more generally in explaining the evolution of legal doctrines. Certainly the more obvious method of providing an advantage to in-state milk producers would be to impose a differential tax on milk sales depending upon the state of origin. But this would just as obviously have violated the per se rule. The *West Lynn Creamery* Court recognized the subterfuge of joining two separate schemes that have the same effect and prevented it from inviting the very retaliatory response that the dormant commerce clause doctrine is designed to prevent. So viewed, this case, like the facially discriminatory statute that is financially motivated, falls within the first core prohibition of the dormant commerce clause.

The *West Lynn Creamery* ruling, applying strict scrutiny and striking down the challenged law, had the effect of discouraging other states from retaliating against the enacting state and thus of discouraging mutual defection in a prisoners' dilemma game. Before proceeding, however, it is important to consider the discussion within *West Lynn Creamery* involving the strong presumption in favor of sustaining state subsidy schemes. While it is true that such schemes are facially discriminatory–only in state constituents receive the benefit–and are financially motivated, the Court suggested that such programs withstand dormant commerce clause scrutiny. Thus, the *West Lynn Creamery* Court reasoned that the problem was in joining the two halves of its tax-and-rebate scheme together with the knowledge that the tax revenues went into a segregated fund used for the rebate scheme. Had the subsidy come from general taxpayer revenues, however, the Court strongly suggested that the case would have come out otherwise.

In contrast, in the subsequent decision, *Camps Newfound/Owatonna, Inc. v. Town of Harrison*,[278] the Court struck down a real estate tax provision in a Maine statute that provided a general tax exemption for charitable organizations, but which excepted from the rule those institutions that primarily serve nonresidents of Maine. A camp serving members of the Christian Science faith who were primarily from out of state,[279] challenged the exemption on dormant commerce clause grounds. Justice Stevens, writing for a majority, stated that the case presented an issue that the Court had not previously addressed, namely "the disparate real estate tax treatment of a non-profit service provider based on the residence of the consumers that it serves."[280] The Court quoted *West Lynn Creamery* for the proposition that "[t]he paradigmatic . .

[277]*Id.* at 215 (Rehnquist, C.J., dissenting).

[278]520 U.S. 564 (1997). For an informative analysis discussing the relationship between these two cases in a manner that is largely consistent with the analysis presented here, see Coenen, *supra* note 212.

[279]The Court noted that 95% of the campers come from out of state. *Id.* at 573.

[280]*Id.* at 572.

. law discriminating against interstate commerce is the protective [import] tariff or customs duty, which taxes goods imported from other States, but does not tax similar products produced in State."[281] The Court further noted that "[s]uch tariffs are so patently unconstitutional that our cases reveal not a single attempt by a state to enact one."[282] The Court went on to explain, however, that if the State tax were allowed to stand, states could enact the functional equivalent of prohibited tariffs by providing "special real estate taxes on property" and then "gearing the increased tax to the value of the imported goods at issue."[283]

As explained in Part III, we can explain the Court's differential treatment of the state as market participant and state law subsidies, on the one hand, and differential taxation, on the other, as a function of the ease with which adversely affected interests in other states can secure reciprocal legislative protections. The more transparent the special interest benefit, the more costly it is to procure. And, conversely, the more well hidden, the less costly to procure. Despite the economic equivalence of these two sorts of legislative preference to the affected businesses or nonprofit organizations,[284] the game theoretical analysis reveals a difference that is worthy of respect in the Court's dormant commerce clause doctrine. Specifically, to the extent that the doctrine is motivated by the desire to inhibit a regime of mutual defection in a standard prisoners' dilemma, we might imagine the Court's results to be graded according to the transparent nature of the differential protectionist measure. So viewed, the market participant doctrine, rather than serving as an anomaly, falls squarely in the category of cases least likely to invite reciprocal defection. Moreover, the analysis is consistent with the intuition that the dormant commerce clause is not targeted against rent seeking as such. Instead, it is targeted against those forms of rent seeking activity that undermine a beneficial regime of mutual cooperation among states.

c. Summary

Table 7 will summarizes the preceding discussion.

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[281] *Id.* at 575 (internal quotations omitted).

[282] *Id.* (internal quotations omitted).

[283] *Id*. The Court further held that the rule prohibiting differential taxation on private businesses applied to nonprofits. *Id.* at 583.

[284] *See* Levmore, *supra* note 212.

Table 7: The Prisoners' Dilemma Cases

Category	Market Participant Doctrine; Export Taxation	Subsidy Cases	Differential Taxation	Tarriffs, Exclusions
Cases	*Reeves, Hughes*, *White, but see Wunnicke*	*West Lynn Creamery*	*Camp Newfound/-Owatonna*	*City of Philadelphia; C&A Carbone*
Comments	Challenged provisions take form of visible wealth transfers from diffuse to organized groups, which are politically costly to procure and thus less likely to invite retaliation.	Suggests that Court generally presumes in favor of subsidy for same reason as prior category unless interest group analysis reveals dynamic that masks functional equivalent of differential taxation.	Because differential taxes are hidden, and thus lower cost to pass, Court is less likely to sustain them as they are more likely to invite retaliation.	Because these cases present the most obvious geographical barriers to trade, Court presumes that they threaten to invite mutual defection. Problem is that in waste context, states retain option to decline permits, thus reinviting defection.
Challenged Statute Not Likely to Promote Regime of Mutual Defection				Challenged Statute Likely to Promote Regime of Mutual Defection

2. The Second Core Value: Restoring a Benign Multiple Nash Equilibrium Game

a. The Paradigm Cases

In *Kassel v. Consolidated Freightways Corp,*[285] the Court struck down Iowa's prohibition against 65-foot twin trailers even though the state had some evidence to support its claim that such vehicles were unsafe, highway safety was traditionally an area in which the Court had stated that deference applied, and along the east coast and in the District of Columbia, the Iowa rule was dominant.[286] And in *Bibb v. Navajo Freight Lines*,[287] the Court struck down an Iowa statute that required curved mudflaps when 45 other states allowed them and one other state prohibited them. These cases present the clearest examples of laws that if sustained would disrupt a multiple Nash equilibrium game among those states that had adopted a common, pro-commerce regime. The effort to secure appropriable quasi rents is seen most easily in *Kassel*, where the governor made plain that the benefit to the state from disallowing a kind of truck that was allowed in surrounding states was to reduce the wear and tear on state highways. Assuming

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[285] 450 U.S. 662 (1981).

[286] *Id.* at 664; 668 n.1 and accompanying text (Rehnquist, J., dissenting).

[287] 359 U.S. 520 (1959).

that the two dominant trucks for the relevant interstate transit were 65-foot twins or 55-foot singles, then had the surrounding states prohibited 65-foot twin trailers, but allowed as a substitute 55-foot singles, Iowa would only be able to secure the quasi rent by disallowing the 55-foot singles in favor of the 65-foot twins. And further notice that Iowa only truly benefits provided that the remaining states retain their common, contrary regime. Otherwise, Iowa, like the states whose scheme it thwarted, would no longer benefit from the reduced cost of commerce to Iowa, facilitated by that common regime, which was furthered by the three exceptions to the 65-foot trailer ban, including most notably the border cities exception.[288]

The critical point is that the rent does not arise from the substance of the nonuniform law. Rather, it arises from the fact that the law is nonuniform. As in the Manhattan hypothetical, Iowa secures the quasi rent only by disrupting whichever Nash equilibrium result the surrounding states adopted. A similar analysis applies in *Bibb*. Whether in fact there was a benefit to straight versus curved mudflaps, when a scheme disrupts one of two Nash strategies commonly in place in numerous states, the Court presumes a likely intent to disprupt a multiple Nash equilibrium game, rather than a genuine effort to further interests of highway safety. In effect, had the Court sustained these statutes by applying low level scrutiny, it would have invited clever state legislators to turn what is essentially a coordination game between and among states into a game in which a defiant state introduces a third mixed strategy equilibrium option that solely benefits itself at the direct expense of interstate commerce. Whether this game is characterized as disrupting a multiple Nash equilibrium game or in terms of appropriating quasi rents produced through the other states' benign pro-commerce strategies, the result is the same. These cases reveal why the Court attempts to restore the states to a simple multiple Nash equilibrium game by taking the option to the defecting state of procuring quasi rents and thus introducing a mixed strategy equilibrium off the table.

Even though the states in these cases cannot formally coordinate, in the absence of a defecting strategy, the probability of a benign, Nash outcome among cooperative states is improved because the decisions of the various state legislatures are not simultaneous. Instead, one state or a group of states sets out a lead policy, and as a consequence of path dependence, resulting in increasing marginal returns from more of the same activity, the surrounding states follow the lead of the early mover or movers. And notice that this need not result from formally enacted rules. Simply declining to prohibit that which other states allow facilitates the desired pro-commerce regime.

Of course the effect of forcing a mixed strategy equilibrium by adopting a contrary option is potentially enormous. The Court has captured this intuition by labeling such efforts as imposing unacceptable burdens on commerce. It is perhaps not surprising then that in *Bibb*, Justice Douglas noted that "[t]his is one of those cases–few in number–where local safety measures that are nondiscriminatory place an unconstitutional burden on interstate commerce."[289] When there are two dominant regimes, for example curved or straight mudflaps, each of which constitutes a Nash equilibrium, and one has become dominant over time, defying that path-induced equilibrium by introducing a nonconforming rule produces a quasi rent that no

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[288] *See supra* at 36-40, and cites therein.

[289] Bibb v. Navaho Freight Lines, Inc., 359 U.S. at 529.

participating states would have reasonably intended a defecting state to appropriate had they thought about the choice of regime ex ante. While some might have preferred one regime or the other, none would have preferred a mixed regime. And aside from the specific benefit of appropriating a quasi rent, this is even true for the defecting state.

While we should not expect to see cycling of the sort hypothesized in part III between potential Nash equilibria outcomes and a mixed strategy outcome,[290] defecting states produce an outcome that undermines the positive network externalities of the surrounding states. It is for that reason that some scholars have characterized these cases as involving hold outs in the production of a public good.[291] But unlike the hold out game, there is no realistic possibility of a payoff by those harmed to purchase the defecting state's cooperation. Instead, the benefit comes from the very act of defection. So viewed, we can appreciate the *Kassel* and *Bibb* holdings as the Supreme Court's decision to remove from the table the option of one state to introduce a mixed strategy equilibrium when doing so allows the defecting state to appropriate a quasi rent, but when it appears improbable that the motivation for the nonconforming law is to secure the benefits of a superior legal regime. Just as preventing a regime of mutual defection, the most common economic explanation for the dormant commerce clause, represents a core value of the Court's doctrine, so too does restoring a benign multiple Nash equilibrium game. If we accept the proposition that the commerce clause, operating in its dormant capacity, has the power to invalidate state laws that undermine political union, then certainly the clause must come into play when a challenged law's only purpose is to benefit at the expense of the other states' benign Nash equilibrium outcomes. And that is just the effect of the challenged laws in *Kassel* and *Bibb*.

a. A Comment on the Default Nature of the Dormant Commerce Clause Rules

Before moving to the next group of cases, it is important now to consider the justification for treating the Court's dormant commerce clause holdings as a set of default rules. In the *Kassel* and *Bibb* context, the effect of removing the disrupting mixed regime option is to reinstate the dominant option. Notice, however, that in *Kassel*, the enacting state was not unique and that there were at least some policy arguments to support the rejected regime. To the extent that these cases suggest that the Supreme Court applies the dormant commerce clause to restore a multiple Nash equilibrium game and to prevent state efforts to secure appropriable quasi rents, path dependence suggests that the doctrine also has the effect of supporting the first mover. The first mover might not, however, have selected the optimal regime or the regime that will prove optimal over time. The choice to allow or disallow 65-foot twins or to demand curved or straight mudflaps might well be different from the choice of right or left hand driving in one critical respect. The latter choice is pure coordination. The former choices combine competing policy judgments with a coordination or path dependence game. The Court's dormant commerce clause doctrine reflects the intuition that the benefits of even a superior highway safety regulation are outweighed by the burdens of disrupting even a somewhat inferior outcome of a coordination

[290] *See supra* part III.B.2.d.

[291] *See* Epstein, *supra* note 204.

game.[292] This intuition is reflected in the *Kassel* plurality's use of a balancing test.

The analysis further helps to explain the default nature of these rules. The Court is institutionally incapable of using the *Kassel* case as a means of imposing on *other states* the Iowa regime prohibiting 65-foot twins. If the Court had that power and if the Iowa regime were in fact superior, such a ruling would simultaneously solve the coordination problem and avoid codifying an inferior regime based upon the high probability that the first mover had a systemic influence in establishing the dominant regime. A similar analysis can be applied in *Hunt*. While it might seem improbable, it is at least possible to imagine that there are benefits to the simpler USDA grading system that outweigh the informational benefits of the alternative Washington grading system or even of a combined regime. Again, however, the Court lacks the constitutional authority to use *Hunt* as a vehicle for imposing the North Carolina regime on the nation as a whole.

The well known problem of Congressional inertia renders the Court's entry into this area problematic because even selecting a default constitutional rule might, as a practical matter, entrench that outcome indefinitely. That said, if the chosen regime does prevent private producers from securing Ricardian rents, or economic rents associated with unique conditions that allow it to produce a product in commerce for which there are limited substitutes, there is at least an incentive to employ the Congressional political process to bring about a change in that rule. I would not be so naive as to suggest that Congress routinely ensures that potential efficiency gains are facilitated through legislation pursuant to the commerce clause. But the analysis of the multiple Nash equilibrium cases provides a strong normative justification for the shift from treating the commerce power as one in which state and federal powers are hermetically sealed (as was the case in an earlier era) to a regime in which Congress can change Supreme Court rulings through ordinary legislation. And while this argument might appear more compelling in the multiple Nash equilibrium cases than in the prisoners' dilemma cases, the waste cases reveal that it is sometimes applicable in both core areas of the Court's dormant commerce clause jurisprudence. The Court's decision to strike down state laws that restrict the flow of waste based upon point of origin might have a greater normative foundation because of the Court's willingness to allow Congress to choose an opposite regime. As suggested previously, however, to the extent that the anticommandeering doctrine developed on the affirmative side of the Court's commerce clause jurisprudence prevents Congress from enacting alternative solutions–including coercing the states to create even state-specific solutions to their own waste storage problems[293]–the analysis further highlights the need for the Court to be more

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[292]The *Bibb* Court appeared to recognize this point:

> Such a new safety device–out of line with the requirements of the other States–may be so compelling that the innovating State need not be the one to give way. But the present showing–balanced against the clear burden on commerce–is far too inconclusive to make this mudguard meet that test.

Bibb, 359 U.S. at 530.

[293]This was essentially the Congressional solution in the Low Level Radioactive Waste Policy Amendments of 1986, through which Congress required states to either provide in-state waste storage or to join a regional pact. The Court struck down this regime in *New York v. United States*, 505 U.S. 144 (1992), holding that Congress lacked the power to commandeer the states by coercing them to become self sufficient or to suffer

attentive to the relationship between both sides of its commerce clause jurisprudence.

This intuition is reinforced by the fact that it would appear most implausible to imagine in a competing Nash equilibrium context–as in *Kassel* and *Bibb*–that Congress would ever select a mixed strategy equilibrium regime.[294] Congress would either leave the Court's selected dominant regime in place, thus prohibiting the outlier statute, or substitute a contrary, but uniform, regime. Similarly in *Hunt*, while it seems unlikely that the informational benefits of the Washington grading system are outweighed by the benefits of simplicity in the USDA system, the Court's ruling at least leaves Congress the option to declare otherwise.

This point can be generalized. To the extent that the Court's dormant commerce clause rules are the product of efforts to limit states in their attempts to disrupt benign multiple Nash equilibrium games and to appropriate quasi rents at the expense of commerce, that suggests that particular Supreme Court rulings cannot be cast in terms of whether the clause anticipates the Court's ruling. Nothing in the commerce clause informs the selection of straight verus curved mudflaps, allowing or prohibiting 65-foot twins, or allowing or prohibiting grading systems for produce with a finer top gradations. But this does not undermine the Court's rulings in this area. While the commerce clause does not inform these specific choices, it does inform the Court's scrutiny in assessing state laws the most logical construction of which is an effort to secure a rent that would not have come into being but for commerce, and that has the effect of undermining the Nash equilibrium, pro-commerce regimes of other states.

a. The Proxy Cases: The Extraterritorial Effects and Anti-Takeover Cases

Another body of dormant commerce clause cases that fits this paradigm, which I have not previously introduced, involves state laws with extraterritorial effect.[295] In a series of cases, the Court has addressed a group of state laws, primarily involving liquor pricing, that required those selling liquor from out of state to post retail prices in the regulating state and to affirm that the posted prices are the lowest price in other identified states for a specified period of time. In the

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draconian sanctions.

[294]*See* BAIRD, *supra* note 205 (describing mixed strategy equilibrium). And in fact Congress has demonstrated its ability to adopt rules that limit the power of states to inhibit the flow of commerce in this area. In The Surface Transportation Act of 1982, apparently in exchange for other provisions that imposed detrimental taxes on truckers, Congress eliminated state restrictions on doubles traveling interstate highways. See 49 U.S.C. 2301, repealed by Pub. L. No. 103-272, 108 Stat. 1379 (1994). In subsequent amendments enacted in 1984, Congress cut back on some of these gains by authorizing the Secretary of Transportation, on the basis of highway safety or on petition of state governors, to prohibit doubles on interstate highways. This suggests that Congress can facilitate a Nash strategy equilibrium, or allow exceptions to a uniform regime in the event that a nation-wide Nash equilibrium outcome proves inferior in particular states or regions. But the critical point is that while the federal judiciary can only sustain or strike down a challenged state law, Congress has the wherewithal to enact as a uniform rule either the dominant or minority rule among the states.

[295]For an essay (or more precisely the second of a pair of essays) that argues that the constitutional notion of extraterritoriality is not grounded in any single clause, including the commerce clause, see Donald H. Regan, *Siamese Essays: (I) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 U. MICH. L. REV. 1865 (1987). Whether or not extraterritoriality resides in a single clause, it is important here to consider its implications for interstate commerce. And the Court's rulings in this area, not surprisingly, have rested upon a construction of the commerce clause operating in its dormant capacity.

most prominent recent decision, *Healy v. The Beer Institute (Healy II)*,[296] the Supreme Court struck down a Connecticut statute that required out-of-state liquor shippers to affirm that their posted prices for products sold in state were no higher than those in the bordering states of Massachusetts, New York, and Rhode Island. The challenged statute was an amended version of one that the United States Court of Appeals for the Second Circuit struck down and that the Supreme Court summarily affirmed in *Healy I.*[297] The earlier version required the shipper to affirm that their prices would remain no higher than the lowest prices they would charge for beer in the bordering states for the effective period of the posting. The version at issue in *Healy II* limited the lowest price affirmation to the time of the posting. In between the two cases, the Supreme Court issued *Brown-Forman Distillers Corp. v. New York State Liquor Authority*.[298] In that case, a New York law required liquor distillers and wholesalers in the state to affirm that bottles or cases of liquor are sold in New York at a price no higher than the lowest price in any other state during the month of the price affirmation. Eighteen years earlier in *Seagram & Sons, Inc. v. Hostetter*,[299] the Court upheld a New York price affirmation statute that required sellers to affirm that the price sold in New York was no higher than that in any state in the U.S. for the preceding month. In that case, the Court grounded its holding in part upon the 21st amendment's broad grant to regulatory power concerning liquor to states. Thus, the Court has issued cases involving affirmation statutes with prospective (*Healy I*), retrospective (*Seagram & Sons*), and present effect (*Healy II*).

The *Healy II* Court also discussed one other case that involved a statute with extraterritorial effect. In *Edgar v. MITE Corp.*,[300] the Court struck down an Illinois antitakeover statute that required a tender offer for a target company in which 10% or more shareholders reside in Illinois to register with the Secretary of State and that prevented the takeover from having effect for 20 days pending administrative evaluation to rule out inequity or fraud. In a subsequent decision, *CTS v. Dynamics Corp.,*[301] the Court sustained against a dormant commerce clause challenge an Indiana statute that permitted control shares in an Indiana corporation to be voted only if other shareholders passed approving resolution. In *MITE*, in contrast, a plurality invalidated the Illinois antitakeover law, finding that it "directly regulate[d] transactions which take place across state lines, even if wholly outside the State of Illinois."[302]

Before considering the *Heally II* Court's analysis, it is worth noting an analytical similarity between that case, which struck down the challenged state law, and *Exxon*, which

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[296] 491 U.S. 324 (1989).

[297] *See United States Brewers Assn., Inc. v. Healy*, 692 F2d 275 (2d Cir. 1982), *summ. aff'd*, 464 U.S. 909 (1983) (*Healy I)*.

[298] 476 U.S. 573 (1986).

[299] 384 U.S. 35 (1966).

[300] 457 U.S. 624 (1982).

[301] 481 U.S. 69 (1987).

[302] 457 U.S. at 641.

achieved an opposite result. As the *Healy II* Court noted, Connecticut had no breweries or brewers, and thus all brewers and importers were located out of state.[303] While the *Exxon* Court rejected the dormant commerce clause challenge to the restriction on vertically integrated retail service stations in part on the ground that the challenged statute did not draw a line between in-state and out-of state firms, in *Healy II*, the Court declined to apply the same reasoning. Even though all liquor came into Connecticut from out of state, the Court struck down the law based upon its extraterritorial effect. And in doing so, *Healy II* Court overruled *Seagram & Sons*.

As stated above, the *Healy II* Court relied both on the earlier liquor affirmation cases and on *Edgar v. MITE* to reject the revised Connecticut statute. After explaining why it no longer construed the 21st amendment as a barrier to dormant clause scrutiny in this area,[304] the *Healy II* Court noted that the law in question was narrower than those it had previously reviewed: "[T]he statute requires only that out-of-state shippers affirm that their prices are no higher than the prices being charged in the border States as of the moment of affirmation."[305] Despite the statute's narrower reach, the Court held that it violated the dormant commerce clause doctrine. The Court distilled the prior cases as follows:

> Taken together, our cases concerning the extraterritorial effects of state economic regulation stand at a minimum for the following propositions: First, the Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State, . . . and, specifically, a State may not adopt legislation that has the practical effect of establishing a scale of prices for use in other states, . . . Second, a statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of the enacting State's authority and is invalid regardless of whether the statute's extraterritorial reach was intended by the legislature. The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State. . . . Third, the practical effect of the statute must be evaluated not only by considering the consequences of the statute itself, but also by considering how the challenged statute may interact with the legitimate regulatory regimes of other States and what effect would arise if not one, but many or every, State adopted similar legislation. Generally speaking, the Commerce Clause protects against inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another State. . . . And, specifically, the Commerce Clause dictates that no State may force an out-of-state merchant to seek regulatory approval in one State before undertaking a transaction in another.[306]

The Court went on to explain that the Connecticut statute operated in a manner that was inconsistent with the actual, or potential, pro-commerce regimes of those states in which the law

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[303]Recall that Maryland had no refiners or processors of gasoline, so all gasoline products were imported.

[304]The Court relied upon *Brown-Forman* for the proposition that "[a]lthough the [21st] Amendment vested in New York considerable authority to regulate the domestic sale of alcohol, the Amendment did not immunize the State from the Commerce Clause's proscription of state statutes that regulate the sale of alcohol in other States." *Id. Healy II*, 491 U.S. at 334-35.

[305]*Id.* at 334-35.

[306]*Id.* at 336 (internal quotations omitted).

had an extraterritorial effect by "preventing brewers from undertaking competitive pricing [in those states] based on prevailing market conditions."[307]

These cases suggest that the Court has identified as a significant proxy for state efforts to disprupt benign multiple Nash equilibrium games and to secure appropriable quasi rents those statutory provisions that directly implicate the laws of other states. While *Exxon* itself reveals that the Court has not consistently applied the second finding in the *Healy II* doctrinal summary, namely presuming against the constitutionality of laws that affect private business conduct beyond the regulating state's borders, the Court has done substantially better at applying the third finding, namely evaluating state regulations in light of their actual or potential impact on the regulatory regimes of other states. This approach is consistent with both core values of the dormant commerce clause identified in this article. After all, sustaining a law that would result in a regime of mutual defection with other states has a strong negative impact on the regulatory regimes of other states, which without provocation would be more likely to favor commerce. And by inhibiting states in their efforts to disrupt benign Nash equilibrium games of other states, the Court further prevents one state from undermining the pro-commerce regimes of another.

In addition, this group of cases reveals that the Court is particularly concerned if the cumulative effect of a statute, if it were also adopted by other states, would undermine the ability of private entities of function in commerce. In effect, the prohibited Illinois antitakeover statute at issue in *MITE* could altogether block a tender offer that would be allowed in other states, just as the *Kassel* and *Bibb* regimes undermined the pro-commerce driving regimes that are common to the surrounding states. This helps to distinguish *MITE* and *CTS*. These two cases establish that while states have free reign to regulate their own corporations, however inefficient the state's corporations law might be, the commerce clause will prevent a single state from undermining the acquisition of corporations through tender offer procedures that are antithetical to the laws of other states in which the corporation is principally located or doing business. This is particularly appropriate in the corporations context given the ability of shareholders to sell off shares in corporations based in states with inefficient regulatory policies.[308] This suggests that the dormant commerce clause doctrine is not concerned with the efficiency of state corporations law per se, except to the extent that such laws appear to disrupt the pro-commerce strategies of other states and to provide in-state constituents with the functional equivalent of appropriable quasi rents that become available only as a result of the pro-commerce laws or practices of other states. The same analysis explains the extraterritoriality cases more generally. In each of these cases, the Court expressed the concern that the state with the affirmation statute threatened to undermine the operation of competitive forces in other states that did not employ similar schemes. The Court found fatal the mere possibility that the challenged statute could have had the effect of undermining the pro-commerce regime of these other states. And in *Healy II* it did so even

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[307]*Id.* at 338.

[308]Indeed, it is for that reason that the Tiebout model holds the greatest promise in assessing the relative efficiency of the stock market, given that shareholders are better able to vote with their feet in this context than in the context of choosing states nor nations. For a more detailed discussion on this point, see Stearns, *supra* note 166.

though as in *Exxon*,[309] the statute did not discriminate between in and out of state firms (given that all brewers and importers were out of state).

The analysis suggests that whereas *Exxon* was treated as an example of inefficient in state rent seeking, the extraterritorial reach of the affirmation statute at issue in *Healy II* placed it instead closer to the multiple Nash equilibrium game cases. The cases are distinguishable because they present different dimensions of the underlying game theoretical problem. And when the challenged statute primarily harms those in state, as in *Exxon*, the Court is more willing to allow the state's own political processes to operate as the final check. This analysis does not hold, however, when the rent seeking statute confers a benefit, as in *Healy II*, that threatens to undermine pro-commerce strategies of other states that do not have a like regulatory regime. The risk here is not one of retaliation. Rather it is in undermining pricing structures that emerge as a result of the cooperative, pro-commerce strategies of other states.

3. The Hard Cases: Those Containing Elements of Prisoners' Dilemma and Multiple Nash Equilibrium Games

a. *Hunt* Revisited

In *Hunt v. Washington State Apple Advertising Commission*,[310] the Supreme Court struck down a North Carolina statute that contains features that are consistent with an effort to secure appropriable quasi rents. The North Carolina statute prohibiting the import of apples in cartons bearing other than USDA labels prevented Washington apple producers, using an alternative set of standards created under Washington law, from signaling superior apple quality relative to other apples marketed throughout the United States as USDA grade A, and thus from securing whatever additional rents were associated with that superior quality. The inability to secure the additional profit resulting from signaling superior quality presumably undermined the incentives to market the apples across the United States. In *Hunt*, the appropriable quasi rents did not result from North Carolina's disrupting a simple coordination game that involved two competing Nash equilibria, as in *Kassel* and *Bibb*. Instead, the rents arose from what looks at a surface level like ordinary in-state legislative rent seeking. Here, the North Carolina apple producers, a relatively concentrated group, received a benefit at the expense of in-state apple consumers, a relatively dispersed group. The critical difference between this case and one that involves pure in-state rent seeking, however, is that but for the Washington State legal regime (permitted in other states), which promoted commerce by allowing producers of superior quality produce to signal that superior quality in marketing, the opportunity to secure this particular rent could not have arisen.

The best means of appreciating the nature of this rent is to identify the divergence between ex ante and ex post expectations. From an ex ante perspective, it is inconceivable that two states would agree to allow producers of an inferior product in one to prevent their competitors from out of state to signal that their competing product is superior. This case might also present a multiple Nash equilbrium-type game among more than two states. If it is

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[309]For a fuller treatment of *Exxon*, see *infra* part IV.B.3.b.

[310]432 U.S. 333 (1977).

inefficient for the Washington producers to customize their packaging on a per state basis,[311] then the effect of complying with the North Carolina law would be to select *either* the North Carolina regime, which presumably would not violate the laws in any other state, or to limit its marketing to states other than North Carolina.[312] The latter option would not affect inter-state coordination, although it would effectively strip Washington apple producers of one significant state-wide market. The former option, however, would undermine the dominant practices (if we assume as seems reasonable that other states allowing the Washington grading system do so by failing to prohibit it), which, again, are pro-commerce. In effect, Washington has coordinated with other states for a common pro-trade regime in which it is permissible to signal quality that is at least as valuable to consumers as USDA grading. If the Court sustained the North Carolina statute, and if Washington producers elected to make that their uniform marketing rule, then the effect would be to secure a rent at the expense not only of Washington apple producers and North Carolina apple consumers, but of potential consumers of Washington apples elsewhere throughout the United States.

1. *Exxon* Revisited

We will now reconsider a case that at a surface level appears to present a doctrinal conflict not only with the extraterritoriality cases, as previously explained, but also with *Hunt*. In *Exxon Corp. v. Governor of Maryland*,[313] Justice Stevens, writing for a majority, upheld a Maryland statute that prohibited producers or refiners of gasoline from owning or operating service stations. As explained in part II, from the perspective of interest group analysis, the two cases appear identical. In each case, an identifiable in-state interest group–the North Carolina apple producers in *Hunt* and the independent service stations in *Exxon*–procured a legislatively conferred rent at the expense of a diffuse group, in-state consumers, with a private out-of-state counterpart. In each case, the legislatively conferred rent produced an inefficiency at the expense of actors in commerce. The North Carolina statute threatened to deprive in-state apple consumers of a superior product that they would have been willing to purchase at the required premium to make exporting cost effective to Washington apple producers. And the Maryland statute threatened to deprive in-state drivers with the benefit of a lower price and more regular supply at some service stations that could only be secured through the additional profit that the owners of vertically integrated stations would secure by not having to hedge against future price increases through the economic equivalent of an insurance premium on the present price of gasoline.

The question then is why these two cases were decided differently. The *Exxon* Court's nominal justification for declining to apply strict scrutiny–that all gas comes from out of state and thus interstate commerce will remain unaffected–is unpersuasive. While the statute does not

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[311] *See supra* note 124, and accompanying text.

[312] Professor Bittker has made a similar observation: "North Carolina's requirement forced the Washington growers either to alter their long-established inspection and grading practices at substantial cost or to abandon the North Carolina market." BITTKER, *supra* note 83, at 6-41. The critical implication is that abandoning its long-established inspection and grading practices would force the Washington growers to alter their practices in other states whose pro-commerce laws or practices permit Washington-based grading.

[313] 437 U.S. 343 (1978).

draw a line between in state and out of state firms, and might have operated to the benefit of some out of state firms, the fact remains that an identifiable subclass out-of-state firms bears the economic burdens of the statute. The better explanation is that unlike in *Hunt*, the challenged statute in *Exxon* did not confer rents that only could have become available as a result of the pro-commerce laws or practices of other states.

The *Exxon* statute did not undermine a Nash coordination game, as in *Kassel*, because there would be no benefit to other states in seeking to change their laws as a consequence of the Maryland legal regime. The challenged statute conferred rents on in-state independents at the expense of in-state consumers. If other states wished to allow the same type of inefficient rent seeking, they could do so, but their decision remained unaffected by the presence or absence of the Maryland statute. Any incentive by other states to follow Maryland's lead would be in response to the pressures of their own independent service stations rather than in response to those business interests disadvantaged by the Maryland rule, a very different group comprising vertically integrated firms. Moreover, unlike in *Hunt*, the Maryland statute did not undermine any other state's pro-commerce practices or laws. Instead, it primarily affected the business decisions of private firms. The decisions of other states to allow or to prevent economically efficient producer- or refiner-owned retail service stations are entirely unaffected by *either* a decision by the Maryland legislature to allow or to prohibit such firms. This is not the case in *Hunt*. While the affect of sustaining the North Carolina statute on the Washington apple producers' ultimate marketing practices remained an empirical question, at a minimum, sustaining the proscription against non-USDA grading threatened to force those producers to adopt a uniform marketing strategy that would retain the North Carolina market for its growers, thus preventing whatever additional premium is attached to the apples if graded on the Washington scale. The result could have been a potentially significant reduction in sales throughout the nation. Alternatively, if the Washington producers elected to have more than one marketing scheme to accommodate the North Carolina statute, then other states might follow suit, insisting on scaled down USDA grading whenever another state passed a statute that signaled superior quality with respect to competitive produce that the USDA grading system could not disclose.

The *Exxon* case is difficult because the rent could not have arisen but for commerce, but the rent was not the product of–and thus did not threaten to undermine–the pro-commerce laws or dominant practices of other states. The case thus supports the intuition that the dormant commerce clause doctrine is concerned more with undermining the pro-commerce regimes of other states than in securing the efficient allocation of resources attendant to in-state rent seeking. And as such, the game theoretical analysis of these two cases, and of the dormant commerce clause generally, bolsters the intuition that the doctrine is designed to promote political rather than economic union. We are now ready to revisit the final puzzle, namely why the Court has disallowed reciprocity statutes that appear to impose barriers to mutual defection in a prisoners' dilemma.

a. The Reciprocity Cases Revisited

In *Sporhase v. Nebraska*,[314] the Supreme Court struck down a provision of a Nebraska

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[314]458 U.S. 941 (1982).

statute that conditioned the withdrawal of groundwater for export on a reciprocal right to have such water imported from the intended state of destination. While the Court upheld other provisions of the Nebraska statute that were linked to conservation,[315] it applied strict scrutiny to strike down the reciprocity provision. As suggested previously, applying a simple tit-for-tat analysis suggests that the Nebraska statute was indeed pro-commerce. After all, if affected states are choosing whether to permit or prohibit water exports, they would presumably be favorably influenced, and thus more likely to permit it, with the Nebraska statute in place.

In addition, different states have different degrees of market power over particular commodities. A state that is a relatively minor player in water exports might be subject to in-state pressures by conservationists to retain water for in-state use. The conservation interests in another state that is a bigger player in the water market might take the Nebraska statute as an opportunity to justify a similar measure. The Nebraska statute, if sustained, threatened to confer a rent upon those who favored conservation at the expense of commerce in a direct sense. Other states might take the bait and use a decision to sustain the reciprocity statute as an opportunity to enact anti-trade measures. Whatever benefit Nebraskans would receive from their conservation efforts would thus threaten to undermine interstate trade by having a direct, and deleterious effect, on the otherwise pro-trade practices or laws of neighboring states. The difficulty with this story, however, is that if Nebraska perceived itself to be a small player that could be harmed by opening up such an option to other states, it would presumably have a disincentive to provide other states that option through the reciprocity statute. Moreover, such statutes can be narrowly tailored to the market–here groundwater–in which even a peripheral player generally possesses substantial market power.

The preceding analysis, however, suggests that the Court might presume that whenever a state law directly implicates the law of another state, as in the extraterritoriality cases, the probable explanation is to secure a rent that would not be available but for the pro-commerce laws or practices of the other state. If so, then one possible explanation for the counterintuitive holdings in the reciprocity cases is that the Court has implicitly categorized these cases on the wrong side of its dormant commerce clause analysis. If the Court treated them for what they are, cases that present laws intended to limit mutual defection in a prisoners' dilemma, then it would have a strong normative foundation for presuming in their favor. But by instead focusing on the proxy of extraterritorial effect, the Court has implicitly and erroneously assumed that the law intends to confer a rent at the expense of commerce. While this provides a potential positive explanation for the case results, it does not provide a compelling normative foundation. The fact remains that such laws are likely welfare enhancing. That said, the cost of the Court's rule is probably relatively low since any protectionist laws that are more likely to pass without a reciprocity law in another jurisdiction in place are also likely be an independent violation of the dormant commerce clause.

a. Summary

Table 9 summarizes the preceding discussion.

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[315] *See supra* note 109 (quoting relevant provision).

Table 9: Multiple Nash Equilibrium Cases

Category	Disrupting Nash or Path Induced Equilibrium Game	Extra-Territorial Effects; Antitakeover	Facially Neutral Law that Potentially Limits Market Conditions Out-of-State	Intra-State Rent Seeking
Case	*Kassel, Bibb*	*Healy I and II, Edgar v. MITE*	*Hunt*	*Exxon, CTS*
Comments	Challenged laws intended to divert traffic around state, rather to select preferred alternative Nash equilibrium, with effect of thwarting positive gains associated with network externalities in neighboring states. Cases reveal importance of default status of dormant commerce clause doctrine, in event that Congress determines rejected Nash outcome to be superior.	Challenged laws seek to protect in-state consumers by limiting application of market forces in other states, and thus confer rents that could not have arisen but for the pro-commerce regimes or practices of other states (*Healy I* and *II*), or seek to protect local shareholders at the expense of efficient tender offers rules in other jurisdictions (*MITE*).	Challenged law seeks to benefit in state apple producers by conferring a rent that can only be made available by limiting the operation of a widely accepted marketing regime from a competitor state, with the threat to force a common marketing regime that would prevent consumers of superior apples from identifying and paying a premium for that superior quality.	Challenged laws confer benefits to in state interests, but do so in a manner that transfers wealth from diffuse to organized interests. The resulting inefficiencies are presumed beyond the limit of the dormant commerce clause doctrine.
Presumption of Effort to Disrupt Benign Multiple Nash Equilibrium Game				Presumption of Intra-State Rent Seeking

I. Conclusion

A common critique of game theory–and of rational choice generally–is that those who employ the these methodologies tend to rely upon the very efficiency-based premises that they are seeking to further in their construction of analytical models. A careful game theoretical analysis, however, has the potential to refute as well as to verify the importance of rules or institutional practices the principal purpose of which is to promote efficiency. The game theoretical model of the dormant commerce clause does not show that the Court has generated outcomes the best explanation of which is to ensure that resources flow to their most highly valued uses, unobstructed by state laws that have the capacity to undermine a unified national market. Instead, the model reveals a set of competing concerns that prove more consistent with a political than economic vision of national union. The Court routinely countenances laws that appear inconsistent with efficiency concerns and that impose potentially significant costs upon the national economy. At the same time, the Court sometimes strikes down state laws that appear well grounded in concerns for economic efficiency. And yet, I have argued, the game theoretical model provides a basis for understanding and for reconciling many of the most criticized results.

I do not contend that the Court's rulings in this area are uniformly correct, or even that they are better than available alternatives in all cases. Rather, I suggest that the Court's rulings reveal a concern that states not enact laws affecting commerce that undermine political union either by encouraging other states to pursue like strategies, or by feeding off the pro-commerce cooperative strategies already in place in other states. I have no doubt that the Court could have resolved certain cases and devised certain doctrines in a manner that would produce more pleasing (dare I say efficient!) results. But constructing a set of doctrines and case results that encourages mutual respect between and among states regarding their commerce-related laws or practices is certainly a compelling–maybe even beautiful–project.