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# Proportionality as Hidden (but Emerging?) Touchstone of American Federalism: Reflections on the Wayfair Decision

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# Proportionality as Hidden (but Emerging?) Touchstone of American Federalism: Reflections on the *Wayfair* Decision

*Darien Shanske\**

## INTRODUCTION

Until June 2018, a state could not require an out-of-state vendor to collect its use tax if the vendor did not have a physical presence in the state. This was the rule in place during the entire rise of the Internet and of e-vendors such as Amazon, which scrupulously avoided physical presence in as many states as possible. The result was a significant tax advantage for remote vendors as compared to brick and mortar stores, as well as increasing revenue losses for states and localities. It would be one thing if the national legislature had decided to confer this dubious tax advantage, yet this rule emerged not from Congress, but from the Supreme Court.

In *South Dakota v. Wayfair, Inc.*,<sup>1</sup> the Court overturned the physical presence requirement. In so doing the Court did more than just take away an unwise tax advantage that remote vendors did not secure through the political process. The Court also restored the ordinary constitutional balance in two related ways. First, the Court restored the states' power to tax unless Congress has specifically preempted that power. To be sure, the Court has restricted the power of state taxation through application of the dormant Commerce Clause, but modern dormant Commerce Clause doctrine is generally respectful of the background norm that states must be permitted the leeway to raise revenue as they see fit.

Thus, and this is the second restoration, the Court corrected an anomalously formal pocket of dormant Commerce Clause jurisprudence where it had crafted a bright-line rule that also had the effect of reversing the constitutional default in favor of state power.

The exact impact of the *Wayfair* decision on the practice and reality of state and local public finance will take many years to

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<sup>1</sup> 138 S. Ct. 2080 (2018).

emerge. In this Article, I consider *Wayfair* in the context of the Court's federalism jurisprudence. I argue that restoring the constitutional balance helps explain why the case came out as it did. Further, I place the Court's approach to federalism in broader perspective, explaining that it illustrates an apt application of the proportionality principle. The proportionality principle is at the center of constitutional adjudication around the world and explicitly so. I demonstrate that this principle is no less powerful in adjudicating issues arising in our federal system, though typically under some other nominal analytic structure.

## I. HISTORY

First in 1967, and then in 1992, the Court had found that the federal Constitution required the physical presence rule to require an out-of-state vendor to collect use tax for that state.<sup>2</sup> Even in 1967, this was a controversially formal and novel gloss on the Due Process Clause and the dormant Commerce Clause.<sup>3</sup> By 1992, due process jurisprudence had moved so far from formal tests that the physical presence rule seemed to have essentially been overturned, and the North Dakota Supreme Court asserted as much.<sup>4</sup> Getting ahead of the Supreme Court clearly piqued some members of the Court, though there was unanimous agreement that, in fact, the North Dakota Supreme Court was correct as to the Due Process Clause.<sup>5</sup> And thus in 1992, in *Quill*, the Court made it clear that the physical presence rule was not required by the Due Process Clause.<sup>6</sup> Rather, and distinguishing the two clauses in this way for the first time, the Court re-affirmed the physical presence rule, but only as emerging from the dormant Commerce Clause.<sup>7</sup>

Shifting the source of the rule had the seemingly momentous implication that Congress could change the rule if it so chose.<sup>8</sup> Yet over the ensuing twenty-five years Congress did not, though there were numerous proposals to do so. One way of analyzing

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<sup>2</sup> See generally *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753 (1967); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), *overruled by* *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018).

<sup>3</sup> See *Bellas Hess*, 386 U.S. at 758. See the powerful dissent written by Justice Fortas on behalf of three Justices. *Id.* at 760 (Fortas, J., dissenting).

<sup>4</sup> See *State ex rel Heitkamp v. Quill Corp.*, 470 N.W.2d 203 (N.D. 1991).

<sup>5</sup> See *Quill*, 504 U.S. at 308.

<sup>6</sup> See *id.* at 305. Interestingly, it is now the Court's due process jurisprudence that leading commentators see as "thinly reasoned," especially in light of *Wayfair*. See Allan Erbsen, *Wayfair Undermines Nicaastro: The Constitutional Connection Between State Tax Authority and Personal Jurisdiction*, 128 YALE L.J.F. (forthcoming 2019), <https://ssrn.com/abstract=3291858>.

<sup>7</sup> See *id.*

<sup>8</sup> See *id.* at 318.

the situation is that Congress was content with the result, perhaps happy that this rule was shielding an infant industry. Alternatively, there is an argument that Congress might have considered overturning *Quill* if only the states had acted to simplify their sales and use tax systems sufficiently.<sup>9</sup>

A counter-narrative argues that Congress, especially the modern Congress, is designed *not* to act and that the states simply could not get quite enough momentum on their side given the determined opposition of remote vendors, states without sales taxes and anti-tax activists.<sup>10</sup> As an empirical matter, Congress seems most likely to act in the interstate context in response to narrow concentrated interests, a finding generally consistent with public choice theory.<sup>11</sup> From this perspective, it would be more likely that Congress would act to shield specific business interests from the states—should the *Quill* rule be removed. We will now have the opportunity to see if this is true, assuming the states overreach somehow.

Given the magnitude of the revenue loss and competitive harm they faced, the states became increasingly creative in asserting nexus even under *Quill*.<sup>12</sup> At the same time, major players, such as Amazon, now found it in their business interest to establish a physical presence in multiple states.<sup>13</sup> Thus, by 2018, the major harm to the states had, to some extent, been mitigated. This situation too could be seen in two ways. On the one hand, one might argue that whatever harm the *Quill* rule had done, it was no longer a pressing problem. On the other hand, one might argue that the *Quill* rule—ostensibly meant to help preserve a uniform market—launched dozens of competing state initiatives to collect the use tax, with more to come as the online market continued to grow in importance.

## II. DECISION

Writing for a 5-4 majority, Justice Kennedy argued that the *Quill* rule was always wrong, and it was not the Court's place to

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<sup>9</sup> This argument was made by the Respondents in *Wayfair*. See Respondents' Brief at 13–17, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018) (No. 17-494).

<sup>10</sup> I made this argument with a co-author in an amicus brief. See Amicus Curiae Brief of Four U.S. Senators in Support of Petitioner at 20–24, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018) (No. 17-494).

<sup>11</sup> See Brian Galle, *Congressional Control of State Taxation: Evidence and Lessons for Federalism Theory*, in *THE LAW AND ECONOMICS OF FEDERALISM* 1, 3 (Jonathan Klick ed., 2017).

<sup>12</sup> See Petition for Writ of Certiorari at 12–16, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), *overruled by* *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018) (No. 01-194).

<sup>13</sup> See *Amazon's Physical Presence (Nexus) in States and the Sales Tax Battle*, AM. INDEP. BUS. ALLIANCE (Sep. 27, 2016), <https://www.amiba.net/amazon-nexus-subsidiaries/> [<http://perma.cc/B3VM-C6M6>].

set down an incorrect rule and then wait for Congress to fix it.<sup>14</sup> Going forward, as a matter of doctrine, the majority held that use tax collection obligations can only be imposed if they satisfy three tests. First, the use tax collection obligation must satisfy due process.<sup>15</sup> This was already true in *Quill*.<sup>16</sup> Second, the use tax collection obligation must satisfy the substantial nexus prong of the *Complete Auto* test.<sup>17</sup> This prong no longer requires physical presence and we know that the South Dakota statute at issue satisfies this test.

A state use tax collection requirement must also pass *Pike* balancing. This issue was remanded to the South Dakota courts to consider, though the Court strongly suggested that the South Dakota statute would survive, explaining that:

First, the Act applies a safe harbor to those who transact only limited business in South Dakota. Second, the Act ensures that no obligation to remit the sales tax may be applied retroactively. S.B. 106, § 5. Third, South Dakota is one of more than [twenty] States that have adopted the Streamlined Sales and Use Tax Agreement. This system standardizes taxes to reduce administrative and compliance costs: It requires a single, state level tax administration, uniform definitions of products and services, simplified tax rate structures, and other uniform rules. It also provides sellers access to sales tax administration software paid for by the State. Sellers who choose to use such software are immune from audit liability.<sup>18</sup>

### III. THE RISE OF *PIKE* BALANCING

In hindsight, the application of *Pike* balancing seems obvious. After all, we all learn in *Constitutional Law I* that this is the test we apply to a facially neutral law that arguably nevertheless imposes too great a burden on interstate commerce. Surely this was the heart of the claim made by remote vendors who have constantly reminded the Court of how many thousands of different sales tax jurisdictions there are in this country.

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<sup>14</sup> See *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2096–97 (2018).

<sup>15</sup> See *id.* at 2093.

<sup>16</sup> See *id.*

<sup>17</sup> See *id.* at 2099 (“[T]he nexus is clearly sufficient based on both the economic and virtual contacts [R]espondents have with the State. The Act applies only to sellers that deliver more than \$100,000 of goods or services into South Dakota or engage in 200 or more separate transactions for the delivery of goods and services into the State on an annual basis. S.B. 106, § 1. This quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota. And [R]espondents are large, national companies that undoubtedly maintain an extensive virtual presence.”).

<sup>18</sup> *Id.* at 2099–100.

Nevertheless, *Pike*'s starring role is surprising. Justice Scalia's disdain for *Pike* balancing is well-known,<sup>19</sup> and a great deal of academic commentary supported his basic point that a balancing test is inherently uncertain, policy-driven, and legislative.<sup>20</sup> The Court had not struck down a statute using *Pike* balancing since the 1980s<sup>21</sup> and the consensus seemed to be that the Court would not do so in *Wayfair*.

This was especially true because the Court seemed to use two different rubrics for analyzing taxes versus regulations.<sup>22</sup> Taxes were subjected to the *Complete Auto* test,<sup>23</sup> which does not include *Pike* balancing. However, regulations were subjected to the usual two levels of test: First facial discrimination analysis, second *Pike* balancing.

As evidence of the no-*Pike* consensus, consider that the Petitioner in *Wayfair*—South Dakota—did not raise *Pike* as an alternative test in its petition for certiorari nor in its merit brief. The argument first appears in an amicus brief at the certiorari stage<sup>24</sup> and then in several other amicus briefs, including, notably, that of the Solicitor General.<sup>25</sup> The Respondents, predictably, dismissed *Pike* in their merits brief as “fundamentally unworkable.”<sup>26</sup>

Yet *Pike* arose immediately in oral argument—at the top of page four of the transcript—during Justice Sotomayor's opening questions.<sup>27</sup> Note that Justice Sotomayor seemed to be of the opinion—as was the amici who first emphasized *Pike*—that *Pike*

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19 See, e.g., *Dep't of Revenue of Ky. v. Davis*, 553 U.S. 328, 360 (Scalia, J., concurring). Justice Gorsuch is clearly not a fan either. See, e.g., *Energy & Env't Legal Inst. v. Epel*, 793 F.3d 1169, 1171 (10th Cir. 2015).

20 See, e.g., Brannon P. Denning, *Reconstructing the Dormant Commerce Clause Doctrine*, 50 WM. & MARY L. REV. 417, 453–58 (2008) (listing common critiques).

21 BRANNON P. DENNING, *BITKER ON THE REGULATION OF INTERSTATE AND FOREIGN COMMERCE* 6–33 (2d ed. 2013).

22 Dan T. Coenen, *Where United Haulers Might Take Us: The Future of the State-Self-Promotion Exception to the Dormant Commerce Clause Rule*, 95 IOWA L. REV. 541, 599 (2010); Edward A. Zelinsky, *The False Modesty of Department of Revenue v. Davis: Disrupting the Dormant Commerce Clause Through the Traditional Public Function Doctrine*, 29 VA. TAX REV. 407, 441 (2010).

23 *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

24 See Amicus Curiae Brief of Four U.S. Senators in Support of Petitioner, *supra* note 10, at 3.

25 See Brief for the United States as Amicus Curiae Supporting Petitioner, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018) (No. 17-494), 2018 WL 1168802; see also Brief of Brill et al. as Amici Curiae Supporting Petitioner, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (No. 17-494), 2018 WL 1203457.

26 Respondents' Brief at 57, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (No. 17-494), 2018 WL 1621148.

27 Transcript of Oral Argument at 4–5, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (No. 17-494), 2018 WL 2446095.

should be used *instead* of *Complete Auto*.<sup>28</sup> In *Wayfair*, the Court chose to engage in both the *Complete Auto* and *Pike* analyses.<sup>29</sup>

#### IV. PROPORTIONALITY AS UNDERLYING PRINCIPLE OF HORIZONTAL FEDERALISM

As a matter of constitutional theory, the proportionality principle is the dominant mode around the world for adjudicating claims where there are strong rights-based arguments on both sides.<sup>30</sup> The typical context in which the principle applies occurs when the rights of an individual, say to privacy or due process, clash with the right of the collective, say to freedom from harm.<sup>31</sup> The proportionality principle permits an abridging of individual rights, but only if the collective need is sufficiently important and only to the extent necessary to satisfy that need.

In the context of horizontal federalism, there is also a clash of rights.<sup>32</sup> Indeed, Justice Kennedy, in summarizing dormant Commerce Clause doctrine, explains that its purpose is “to accommodate the necessary balance between state and federal power.”<sup>33</sup> Put in the language of rights, there is the right of subnational governments, here states, to regulate as their citizens think best. But there is also a right of the collective nation not to be overburdened by particular state regulations, as well as the rights of individuals (and businesses) in other states not to be subjected to “foreign” regulations, let alone burdensome ones. As in the case of individual rights, application of the proportionality principle in borderline cases is apt. *Pike* balancing applies this principle, as does the very similar search for sufficiently “substantial nexus.”<sup>34</sup> It is the primary contention of this Article that, however implicit and necessarily messy, the use of proportionality analysis is correct.

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<sup>28</sup> *See id.*

<sup>29</sup> *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2092–93, 2099 (2018).

<sup>30</sup> *See, e.g.,* Bernhard Schlink, *Proportionality in Constitutional Law: Why Everywhere but Here?*, 22 DUKE J. COMP. & INT’L L. 291 (2012) (explaining and comparing balancing and proportionality).

<sup>31</sup> *See, e.g.,* Alec Stone Sweet & Jud Mathews, *Proportionality Balancing and Global Constitutionalism*, 47 COLUM. J. TRANSNAT’L L. 72, 89 (2008); Vicki C. Jackson, *Ambivalent Resistance and Comparative Constitutionalism: Opening Up the Conversation on “Proportionality,”* *Rights and Federalism*, 1 U. PA. J. CONST. L. 583, 626 (1999).

<sup>32</sup> *See* Jackson, *supra* note 31, at 623–34. Jackson’s analysis focuses on the *City of Boerne v. Flores*, 521 U.S. 507 (1997), decision, discussed briefly below.

<sup>33</sup> *Wayfair*, 138 S. Ct. at 2090.

<sup>34</sup> Adam Thimmesch argues, and I agree, that the substantial nexus prong is essentially the same as *Pike* balancing. Adam B. Thimmesch, *A Unifying Approach to Nexus Under the Dormant Commerce Clause*, 116 MICH. L. REV. ONLINE 101, 106 (2018).

V. PROPORTIONALITY IS IN: EXTRATERRITORIALITY IS OUT (AND RIGHTLY SO)<sup>35</sup>

Towards the end of the briefing in *Wayfair*, a doctrine credibly reported as dead<sup>36</sup> made a determined attempt to return from the grave. This doctrine is called the extraterritoriality doctrine, dubbed by then-Judge Gorsuch as “most dormant.”<sup>37</sup> At the margins, this doctrine is unassailable. California cannot impose a regulation on farms in Missouri. It would seem like such a law would fail under any number of constitutional provisions, including not only the Due Process Clause but also the dormant Commerce Clause.

On the other hand, California can clearly regulate the food that is sold in California. The effect of those consumer regulations might well be felt by farmers in Missouri. Does such a regulation have a forbidden extraterritorial effect? The answer based on standard dormant Commerce Clause jurisprudence would be to apply *Pike* balancing. If the California regulation imposed a burden on interstate commerce out of all proportion to the benefit it provides, it would fail.

Yet there is also the extraterritoriality doctrine, which, according to one formulation, requires a court to determine “whether the practical effect of the regulation is to control conduct beyond the boundaries of the State.”<sup>38</sup> Such a test would strike down hundreds of state laws,<sup>39</sup> including presumably use tax collection laws which, of course, are directed at out-of-state vendors. A strong appeal to the extraterritoriality doctrine was made by Paul Clement, a former Solicitor General.<sup>40</sup>

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<sup>35</sup> Note that this section draws from a White Paper on the dormant Commerce Clause that was co-written with Anna Zaret. See generally ANNA ZARET & DARIEN SHANSKE, NAT’L INST. FOR HEALTH POL’Y, THE DORMANT COMMERCE CLAUSE: WHAT IMPACT DOES IT HAVE ON THE REGULATION OF PHARMACEUTICAL COSTS? (2017).

<sup>36</sup> See Brannon P. Denning, *Extraterritoriality and the Dormant Commerce Clause: A Doctrinal Post-Mortem*, 73 LA. L. REV. 979, 1106 (2013).

<sup>37</sup> *Energy & Env’t Legal Inst. v. Epel*, 793 F.3d 1169, 1172 (10th Cir. 2015). Note that Justice Gorsuch refers to this decision in his concurrence in *Wayfair*, as an example of his thinking about the dormant Commerce Clause. See *Wayfair*, 138 S. Ct at 2100–01 (Gorsuch, J., concurring).

<sup>38</sup> *Healy v. The Beer Inst.*, 491 U.S. 324, 336 (1989).

<sup>39</sup> See Jack L. Goldsmith & Alan O. Sykes, *The Internet and the Dormant Commerce Clause*, 110 YALE L.J. 785, 808 (2001); see also Gillian E. Metzger, *Congress, Article IV, and Interstate Relations*, 120 HARV. L. REV. 1468, 1486 (2007); Denning, *supra* note 36, at 1000.

<sup>40</sup> See Brief for Amici Curiae Nat’l Taxpayers Union Found. et al., in Support of Respondents, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018) (No. 17-494), 2018 WL 1709085, at \*6. Clement likely knew that the extraterritoriality argument was made in *Pharma v. Walsh* on behalf of the Chamber of Commerce by none other than John Roberts, now the Chief Justice. See Brief for the Chamber of Commerce of the United States as Amicus Curiae in Support of Petitioner, *Pharm. Research & Mfrs. of Am. v. Walsh*, 538 U.S. 644 (2003) (No. 01-188), 2002 WL 31120077, at \*15. It is thus all the more striking that the argument got no traction at all in *Wayfair*.

The Court first invalidated a state law for violating the prohibition on extraterritoriality in *Baldwin v. G.A.F. Seelig*.<sup>41</sup> That case involved a New York state law that banned the sale of milk produced out-of-state unless the seller paid a minimum price set by New York when she purchased the milk out-of-state.<sup>42</sup> The unanimous decision said that New York improperly “project[ed] its legislation” beyond its boundaries by dictating the terms of transactions that took place in other states.<sup>43</sup> The most recent application of the doctrine was in *Healy v. The Beer Institute*, where the Court struck down a Connecticut law that required out-of-state beer distributors to affirm that their prices in Connecticut “were and would remain no higher than the lowest prices they would charge for each beer product in the border [s]tates.”<sup>44</sup>

It was in *Healy* where the Court made the sweeping statement that the inquiry is whether “the practical effect of the regulation is to control conduct beyond the boundaries of the State.”<sup>45</sup> Since *Healy*, the Court has not applied the doctrine and, indeed, the doctrine has been criticized because of its potentially vast sweep—sweep inconsistent with federalism values. This point was made in a leading law review article in 2001, and both the Supreme Court and lower courts seem to have taken its lesson to heart by allowing the doctrine to become most dormant.<sup>46</sup>

The leading non-application of the doctrine occurred in *Pharmaceutical Research and Manufacturers of America v. Walsh* in 2003.<sup>47</sup> In that case, Maine enacted a program that encouraged drug manufacturers to enter into rebate agreements with the state.<sup>48</sup> The rebate agreements allowed Maine to provide residents with drugs at discounted prices.<sup>49</sup> To get drug manufacturers to enter the agreements, the state decided to impose Medicaid “prior authorization” procedures on the products of any manufacturer that refused to join the program.<sup>50</sup> The prior authorization procedures generally made the drug less likely to be prescribed and ultimately sold to Medicaid patients. Thus, the state threatened to reduce

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<sup>41</sup> 294 U.S. 511, 519 (1935).

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 521.

<sup>44</sup> 491 U.S. 324, 327 (1989).

<sup>45</sup> *Id.* at 336.

<sup>46</sup> See Goldsmith & Sykes, *supra* note 39, at 789–90. For the history and similar analysis, see Denning, *supra* note 36, at 979. The Goldsmith & Sykes article was cited to in the briefing in *Walsh*. Brief of the Nat'l Conference of State Legislatures et al. as Amici Curiae Supporting Respondents, *Pharm. Research & Mfrs. of Am. v. Walsh*, 538 U.S. 644 (No. 01-188), 2002 WL 31506948, at \*23.

<sup>47</sup> *Pharm. Research & Mfrs. of Am. v. Walsh*, 538 U.S. 644, 669 (2003).

<sup>48</sup> *Id.* at 651.

<sup>49</sup> *Id.* at 653–54.

<sup>50</sup> *Id.* at 655.

manufacturer's market share and sales unless it joined the program.<sup>51</sup> The drug manufacturers argued that the law impermissibly regulated out-of-state commerce because it had the inevitable effect of controlling the terms of out-of-state sales between manufacturers and wholesale distributors.<sup>52</sup> Maine argued that the only extraterritorial effect of the law was that it potentially impacted price negotiations between those two parties by reducing the manufacturer's revenue.

The Court unanimously agreed that there was no dormant Commerce Clause violation because the Maine law did not regulate out-of-state transactions, either "by its express terms or its inevitable effect," echoing the conclusion of the First Circuit.<sup>53</sup> Accordingly—as Professor Brandon P. Denning wrote in an article reviewing the rise and fall of the extraterritoriality doctrine—in the modern era extraterritoriality is "for all intents and purposes, dead."<sup>54</sup> However, and returning to where we started, a state that expressly regulates out-of-state conduct directly is a problem. But that is not the kind of law that is typically at issue. For example, the use tax collection laws regulate how an out-of-state vendor must conduct its *in-state* sales.

Therefore, the extraterritoriality doctrine is not even necessary. The problem with the linking laws struck down in the leading extraterritoriality cases can be explained using *Pike* balancing.<sup>55</sup> The problem with linking is that it imposes a significant burden on interstate business, and for little gain. Indeed, the burden could be impossible if every state regulated prices based on every other state's prices.

It is dangerous to draw conclusions from the dog that did not bark of course. Still, it is striking that the formal—and most definitely non-balancing—test of extraterritoriality got no traction, even as *Pike* took center stage.

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<sup>51</sup> *Id.* at 656.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.* at 645.

<sup>54</sup> Denning, *supra* note 36, at 1006.

<sup>55</sup> *Energy & Env't Legal Inst. v. Epel*, 793 F.3d 1169, 1173 (10th Cir. 2015). Indeed, then-Judge Gorsuch and Judge Sutton argued that the extraterritoriality cases also could have been decided on the basis of illicit discrimination. *See also Am. Beverage Assoc. v. Snyder*, 735 F.3d 362, 381 (6th Cir. 2013) (Sutton, J., concurring) (arguing that all cases that apply extraterritoriality to strike down a state law, involved dormant Commerce Clause protectionism concerns).

## VI. PROPORTIONALITY AS UNDERLYING PRINCIPLE OF VERTICAL FEDERALISM

It is worth noting here that the recent leading case on *vertical* federalism (*NFIB v. Sebelius*) also relies on the proportionality principle. In this area, the question is how to balance the legitimate desire of the central government to advance national goals with the ability of the states to choose other goals. The rule here seems to be that the federal government can do quite a lot to encourage states, but not too much. Consider the details of the Court's ruling on the Medicaid expansion in *NFIB v. Sebelius*—the first Obamacare decision.<sup>56</sup> The Court made it clear that the federal government can spend—and not spend—in order to cajole the states to cooperate with it. But the federal government cannot go too far and coerce the states by taking away a major source of funding on which they had come to rely.<sup>57</sup>

And proportionality plays an explicit role in another key vertical federalism decision, *City of Boerne v. Flores*.<sup>58</sup> There the question is how far Congress's power extends under Section 5 of the Fourteenth Amendment.<sup>59</sup> Clearly Congress's enforcement power must extend to protect the rights granted by the Amendment and, yet, those rights are broad and if Congress's enforcement power were also broad, then that would give Congress an enormous amount of power to preempt state law. The Court, in an opinion by Justice Kennedy, resolved the conflict between the need of the central government to enforce national law and that of the states to retain their powers to regulate by crafting a proportionality test: "There must be a congruence and proportionality between the injury to be prevented or remedied and the means adopted to that end."<sup>60</sup>

## VII. ANOTHER QUIET DOG: *MURPHY V. NCAA*

In *Murphy v. NCAA*,<sup>61</sup> a decision authored by Justice Alito, and joined by Chief Justice Roberts and Justices Kennedy, Thomas, Kagan, and Gorsuch, the Court struck down a federal law that made it unlawful for states or their subdivisions to authorize betting on sporting events.<sup>62</sup> The majority thought that this

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<sup>56</sup> 567 U.S. 519 (2012).

<sup>57</sup> For further analysis, see Darien Shanske & David Gamage, *The Federal Government's Power to Restrict State Taxation*, 81 ST. TAX NOTES 547, 550 (2016).

<sup>58</sup> 521 U.S. 507, 512 (1997).

<sup>59</sup> *Id.* at 516–17.

<sup>60</sup> *Id.* at 520.

<sup>61</sup> *Murphy v. Nat'l Collegiate Athletic Ass'n*, 138 S. Ct. 1461 (2018).

<sup>62</sup> *Id.* at 1468.

decision followed from the anti-commandeering principle, namely that “Congress cannot issue direct orders to state legislatures.”<sup>63</sup>

Daniel Hemel has made the strong case that this dicta throws into doubt the many statutes in which Congress tells the states that they may not tax a given transaction or party.<sup>64</sup> After all, in those statutes, Congress is telling state legislatures what they cannot do, and as to a matter inherent to their sovereignty, namely how to raise revenue.

Many commentators replied to Hemel that this cannot be what *Murphy* means, offering various arguments as to how the Court (and in the meantime courts) can follow *Murphy* but not take it so far.<sup>65</sup> Even the Court does not seem to think that *Murphy* implies that Congress cannot preempt state tax legislation, since all nine Justices in *Wayfair* seemed to believe that Congress can (and should) provide uniform ground rules in this area.<sup>66</sup> The structure of such a statute must, out of necessity, forbid state legislatures from passing certain kinds of tax laws.

But what is the underlying *reason* that *Murphy* should not be read in this way? Put another way, I think there are ways to distinguish *Murphy*, but why should we do so? Or rather, why did it seem obvious to the Justices in *Wayfair* that Congress can preempt state taxing power in connection with the use tax no matter the implication of the dicta in *Murphy*? Again, I would argue that it is because the proportionality principle is the proper way to adjudicate clashes of broad constitutional principles.<sup>67</sup> Of course, the national government must be able to exert some control over state taxing power, but that control cannot go too far, or it would undermine the ability of the states to operate as sovereigns.

The restriction on state legislative power struck down in *Murphy*, on this reading, is better understood as the federal government going too far rather than failing a formal test as to who it is commandeering.<sup>68</sup> Consider how Justice Alito chooses to

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<sup>63</sup> *Id.* at 1478.

<sup>64</sup> Daniel Hemel, *More on Murphy—and a Response to Critics*, MEDIUM (May 16, 2016), <https://medium.com/whatever-source-derived/more-on-murphy-and-a-response-to-critics-471b35c75ecb> [http://perma.cc/7YKF-6SZ5].

<sup>65</sup> See, e.g., Rick Hills, *Murphy v. NCAA’s Escape from Baseline Hell*, PRAWFSBLAWG (May 16, 2018, 7:11 PM), <https://prawnsblawg.blogspot.com/prawnsblawg/2018/05/murphy-v-ncaas-escape-from-baseline-hell.html> [http://perma.cc/LYS5-8M99].

<sup>66</sup> See generally *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018).

<sup>67</sup> Brian Galle, for instance, makes a similar argument. See Brian Galle, *Murphy’s (Misguided) Law*, MEDIUM (May 15, 2018), <https://medium.com/whatever-source-derived/murphys-misguided-law-8c22889918e4> [http://perma.cc/9XMD-X75N].

<sup>68</sup> Obviously, as to *Murphy*, this requires reading the opinion against itself. See *Murphy*, 138 S. Ct. at 1485.

develop the facts underlying the case; he starts with: “Americans have never been of one mind about gambling, and attitudes have swung back and forth.”<sup>69</sup> The federal government has thus taken a position on a controversial topic on which there is considerable disagreement and on which there seems to be little imperative for a national solution.

#### VIII. WAYFAIR ITSELF AS A BALANCING DECISION

*Wayfair* was decided 5-4.<sup>70</sup> One might assume that the four dissenters thought that the *Quill* rule should be upheld because *Quill* itself (and *Bellas Hess*) was correctly decided. For instance, the *Quill* rule does arguably provide certainty. Yet, in the end, not a single Justice would stand up for the rule of *Quill*; but then why was this a 5-4 decision?

The four dissenters argued that stare decisis should protect the *Quill* rule—even though it was always a mistake—because it is an old rule that Congress can change.<sup>71</sup> I take the key part of the majority response to be the following:

While it can be conceded that Congress has the authority to change the physical presence rule, Congress cannot change the constitutional default rule. It is inconsistent with the Court’s proper role to ask Congress to address a false constitutional premise of this Court’s own creation. Courts have acted as the front line of review in this limited sphere; and hence it is important that their principles be accurate and logical, whether or not Congress can or will act in response. It is currently the Court, and not Congress, that is limiting the lawful prerogatives of the States.<sup>72</sup>

Put another way, Justice Kennedy is arguing that federalism values establish a pro-state power default and that it is untenable for a federal court, as a court, to erect a barrier to state power based on a mistake.

But note that the dissent’s ode to stare decisis was written by Chief Justice Roberts,<sup>73</sup> who, in another context wrote: “The dormant Commerce Clause is not a roving license for federal courts to decide what activities are appropriate for state and local government to undertake . . . .”<sup>74</sup> The issue in that case, *United Haulers Ass’n., Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, was whether a public utility could force local users to use its waste

<sup>69</sup> *Id.* at 1468.

<sup>70</sup> *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2087 (2018).

<sup>71</sup> *Id.* at 2102 (Roberts, C.J., dissenting).

<sup>72</sup> *Id.* at 2096–97.

<sup>73</sup> *Id.* at 2102.

<sup>74</sup> *United Haulers Ass’n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 343 (2007).

treatment services, and Chief Justice Roberts held for the majority that it *could*.<sup>75</sup> Justice Alito wrote a powerful dissent in this case and was joined by Justice Kennedy.<sup>76</sup> Justice Alito again joined Justice Kennedy in *Wayfair*.<sup>77</sup> Thus, according to Justices Alito and Kennedy, a pro-state constitutional default does not protect local flow control ordinances, but does protect the ability of states to impose a use tax collection obligation. Note that one cannot distinguish *Wayfair* from *United Haulers* because of stare decisis, as in both cases there was a precedent on point that had to be overturned in fact (or de facto, as in *United Haulers*).

How do we think through this tangle? Through how the Justices weighed the facts. Consider Chief Justice Roberts. In *United Haulers*, Chief Justice Roberts began his decision explaining why waste treatment was a significant and intractable problem of the sort that he clearly thought it appropriate for local governments to solve.<sup>78</sup> By contrast, in *Wayfair*, Chief Justice Roberts emphasized that the problem of use tax collection had apparently been largely solved and so there was no reason to destabilize matters by changing a flawed rule, especially a rule that Congress could change.<sup>79</sup>

For Justice Alito in *United Haulers* (and Justice Kennedy who signed onto his dissent), opening the door for local governments to force residents to use their services was sure to lead to wave after wave of local protectionist strictures.<sup>80</sup> For Justice Kennedy in *Wayfair* (and Justice Alito who signed on to his majority opinion),<sup>81</sup> the states' struggle to mitigate an incorrect rule while waiting for Congress to act, was itself a significant harm. Justice Kennedy also did not agree that the *Quill* problem had been largely solved.

## IX. CONCLUSION: DON'T FEAR THE SCALES

As it turns out, I think Chief Justice Roberts was correct in *United Haulers* and that Justices Kennedy and Alito were correct in *Wayfair*. What should one make of this dissensus? Does it not indicate that there is no underlying principle, just

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<sup>75</sup> See *id.* at 347.

<sup>76</sup> See *id.* at 355 (Alito, J., dissenting).

<sup>77</sup> *Wayfair*, 138 S. Ct. at 2087.

<sup>78</sup> *United Haulers*, 550 U.S. at 334.

<sup>79</sup> See *Wayfair*, 138 S. Ct. at 2103 (Roberts, C.J., dissenting) (“States and local governments are already able to collect approximately [eighty] percent of the tax revenue that would be available if there were no physical-presence rule.”).

<sup>80</sup> *United Haulers*, 550 U.S. at 364 (Alito, J., dissenting) (“Experience in other countries, where state ownership is more common than it is in this country, teaches that governments often discriminate in favor of state-owned businesses (by shielding them from international competition) precisely for the purpose of protecting those who derive economic benefits from those businesses, including their employees.”).

<sup>81</sup> *Wayfair*, 138 S. Ct. at 2087.

legislative judgments? Or, if there is a principle, don't the different results indicate that the principle is failing to produce the kind of predictable results required by the rule of law? These are big questions, and oft-debated ones. I think considering our little universe of dormant Commerce Clause cases illustrates why one might be—and I am—satisfied with these somewhat unsettled results.

When the Justices engage in proportionality analysis, they are weighing substantial principles that are in conflict. The resulting balance between principles is itself a kind of principle. That is, once a certain judicial balance is chosen, it applies to all states, not just favored ones. All states can impose a use tax collection obligation if they follow South Dakota's lead. All localities can impose a flow control ordinance directing residents to use a publicly-owned facility.

This is not like ordinary legislative balancing. A government needs to set a tax rate or a set of tax rates, and, though this is also an inexact science, it does not necessarily involve a clash of principles. No one has a rights-based claim to be in a particular tax bracket in the abstract. Tax rates reflect a balance of considerations, but typically not a balance of rights of constitutional dimension. Further, once the rates are set, the government can give out—and does give out—tax breaks reducing the taxes of some for narrow policy reasons, even if the reasons are daft (and are truly just political giveaways).

Though proportionality judgments are not merely legislative judgments, the final balancing as to constitutional principles will change with time, and with Justices. Is there not something incongruous about the Court returning to the fray again and again, often with fractured opinions, in order to achieve balance? Not if one recognizes that the balancing is itself a requirement because of the import of the competing imperatives being considered. Adopting a formal rule is ultimately to discount the principle on one side, as the *Quill* rule did violence to the interests of the states.

Since the balancing must itself be a product of judgment, we assess its quality except on the basis of how the balancing is actually done. To some extent, we do not yet know the answer, as many post-*Wayfair* “balancings” await the courts. That said, in upholding the quite reasonable South Dakota statute, the Court has gotten us off to a promising start.<sup>82</sup>

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<sup>82</sup> Hayes Holderness, *Navigating 21st Century Tax Jurisdiction* (Jan. 11, 2019) (unpublished manuscript), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3314272](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3314272).

Even if appropriate for the Court to engage in this kind of balancing in the abstract, what about the weak textual warrant for our courts doing so? The textual warrant of the dormant Commerce Clause is another huge question but note that fact-intensive inquiries analogous to *Pike* balancing are a feature of international trade law—that is to agreements that nations have explicitly negotiated among themselves.<sup>83</sup> This makes sense. Parties to a free trade agreement reasonably desire a backup test should facially non-discriminatory local laws cause a discriminatory effect. Thus, Congress has already acceded to balancing rules in the context of facilitating an international free trade zone. If Congress passed a law about interstate commerce, it would presumably use a similar rubric to police the domestic free trade zone.<sup>84</sup> It would then be up to the Supreme Court to apply that statute and that application would look pretty much exactly like current dormant Commerce Clause cases. The Court's dormant Commerce Clause jurisprudence was thus once prescient and remains necessary. As the *Quill* saga demonstrates, throwing matters back to Congress is a fraught enterprise, even when there is broad consensus as to what should be done. We are stuck with the dormant Commerce Clause.

In sum, *Wayfair* holds that the states may impose a use tax collection obligation on remote vendors, but not if the burden placed upon them is too great because such a burden undermines the national marketplace.<sup>85</sup> How much is too much will be decided via a common law process and that is, I contend, just how it should be and must be. The only problem with the current state of affairs is that the operative analytic principle, namely the proportionality principle, has not been embraced as such by the Court. Given its cosmopolitan provenance, it seems unlikely that such an explicit embrace will come anytime soon.

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<sup>83</sup> See, e.g., Daniel A. Farber & Robert E. Hudec, *Free Trade and the Regulatory State: A GATT's-Eye View of the Dormant Commerce Clause*, 47 VAND. L. REV. 1401, 1421 (1994) (“As is true of DCC doctrine, the GATT law also deals with facially neutral measures that disadvantage foreign firms compared with domestic ones.”).

<sup>84</sup> Indeed, Congress does use the “unreasonable burden” test in narrow interstate contexts. See 49 U.S.C. § 40116(d) (2018).

<sup>85</sup> See *supra* Part II.

