Limiting Interstate Commerce Clause Scrutiny - Reeves, Inc. v. Stake

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"[E]very consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any [state]."1

Courts have interpreted the commerce clause2 to restrain states' ability to regulate interstate commerce.3 The Supreme Court has enforced this limitation on state power to keep open the free flow of commerce between the states.4 Under the commerce clause, the Court traditionally has applied a balancing test to determine the validity of a state statute restricting the flow of interstate commerce. The state justification for the barrier is weighed against the resulting effect on interstate commerce,5 generally without regard to the form or nature of the state action.6 Recently, however, the

2. U.S. Const. art. I, § 8, cl. 3 provides that Congress has the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."
3. See e.g., Freeman v. Hewit, 329 U.S. 249, 252 (1946) (the commerce clause by itself limits the power of the state to interfere with interstate commerce); Southern Pac. Co. v. Arizona, 325 U.S. 761, 769 (1945) (the commerce clause absent congressional legislation affords some protection against state interference with interstate commerce). For a discussion of the historical development of the implied restraints of the commerce clause, see L. Tribe, American Constitutional Law 320-27 (1978) [hereinafter cited as Tribe].
5. See, e.g., Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366, 379-82 (1976) (Mississippi statute barring acceptance of out-of-state products unless seller's state accepted Mississippi products, enacted to protect the health of Mississippi citizens, weighed against the resulting effect of cutting off markets to businesses which could more efficiently produce the product); Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (Arizona statute requiring all cantaloupe offered for sale to be packaged in closed containers within the state, enacted to protect the reputation of Arizona growers, weighed against the resulting effect of forcing out-of-state packagers to relocate within the state); Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1951) (Madison, Wisconsin ordinance requiring milk sold to be processed within a five mile radius, enacted for local health reasons, weighed against the resulting effect of insulating the milk industry from competition); H.P. Hood & Sons v. Du Mond, 336 U.S. 525, 529-41 (1949) (New York statute allowing denial of license for receiving plant to an out-of-state milk buyer, enacted to protect in-state supply of milk, weighed against the resulting effect on competition).
Court carved out an exception to the use of a balancing test when the state affected interstate commerce through its own involvement as a market participant. Although the state's market participation may have noticeably burdened interstate commerce, the Court held that scrutiny of the state action under a balancing test was not warranted because the state did not erect the type of trade barriers typically forbidden by the commerce clause. Thus, a state acting as a market participant was allowed to limit its market interaction to businesses within its boundaries.

In its most recent commerce clause decision, the United States Supreme Court applied the market participant designation to a state which had effectively erected a total barrier to interstate commerce through its participation in the market. In Reeves, Inc. v. Stake, the Court decided that South Dakota's manufacture and sale of cement through a state owned and operated business qualified South Dakota as a market participant. The Court did not apply commerce clause scrutiny under the balancing test, and South Dakota was permitted to implement a resident preference program to favor in-state businesses. Critically, however, the Court failed to recognize that South Dakota, by participating in the market, not only made interstate commerce more burdensome for out-of-state interests, but also had closed its borders to them. The Court improperly applied the market participant designation to avoid the need to examine the consequences of state action. As a result, the Court did not determine whether the participation in the market, in fact, created the type of trade barrier that should have triggered commerce clause scrutiny under the balancing test.

**BACKGROUND**

**Balancing Test**

Application of the implied restraints of the commerce clause on state action is based on the premise that the United States comprises a national
marketplace.\textsuperscript{15} State action that erects trade barriers contravenes this premise.\textsuperscript{16} Consequently, through a balancing test, the Court has traditionally scrutinized state action limiting out-of-state businesses’ access to in-state markets. This balancing test has been uniformly applied when an out-of-state business either sought to compete with in-state interests\textsuperscript{17} or claimed equal access to in-state resources.\textsuperscript{18} Therefore, any state restriction or regulation of the interaction of private parties across state lines has been subject to review.

Commerce clause scrutiny of state action under the balancing test consists of a three step analysis. First, if the challenged state action evenhandedly affects both in-state and out-of-state interests the incidental effect on interstate commerce is permissible.\textsuperscript{19} Second, if the state action treats in-state and out-of-state businesses differently, the burden is on the out-of-state businesses to demonstrate that state action "discriminates against interstate commerce on its face or in practical effect."\textsuperscript{20} The out-of-state business must show either that the state action is purposefully designed to limit the access of out-of-state business to in-state markets,\textsuperscript{21} or that the practical effect of state

\begin{footnotesize}
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\item See, e.g., Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 803 (1976) (commerce clause protects the right to participate in the national marketplace); Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366, 370 (1976) (free trade among states is to be protected under the commerce clause).
\item Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 527 (1935). Justice Cardozo stated that state power does not include the ability to establish economic barriers against competition from the products of another state. Such restrictions limit the mobility of commerce and neutralize competitors' natural advantages. \textit{Id.}
\item See, e.g., Robertson v. California, 328 U.S. 440, 446-49 (1946) (California statute regulating insurance agents applied to both in-state and out-of-state agents without significant effect on interstate commerce); Milk Control Bd. v. Eisenberg Farm Prods., 306 U.S. 346, 352-53 (1939) (Pennsylvania statute regulating price charged by local sellers designed to regulate the local market with only incidental effects on interstate commerce).
\item See id. at 336-38 (state statute forbidding the sale of natural minnows out-of-state purposefully discriminates against interstate commerce); City of Philadelphia v. New Jersey, 437 U.S. 617, 627 (1978) (New Jersey statute restricting only out-of-state waste suppliers from using in-state landfill cites purposefully blocked the flow of interstate commerce); H.P. Hood & Sons v. Du Mond, 336 U.S. 525, 527-38 (1949) (New York statute allowing denial of license for receiving plant to an out-of-state milk buyer purposefully limited competition in favor of in-state interests); Pennsylvania v. West Virginia, 262 U.S. 553, 592-97 (1923) (West Virginia statute forbidding the exportation of natural gas to protect supply for in-state consumption was impermissible discrimination). With the exception of the \textit{Hood} case, the challenged state action attempted to conserve a local resource. The Court has reviewed these types of statutes regardless of whether the resource was "natural or created." West v. Kansas Natural Gas Co., 221 U.S. 229, 235-56 (1911).
\end{enumerate}
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action precludes in-state market interaction with out-of-state interests.\textsuperscript{22} Third, once the out-of-state interest establishes discrimination, the burden shifts to the state. The state must prove that a legitimate local purpose exists for its action.\textsuperscript{23} The state must then demonstrate the unavailability of any less discriminatory alternatives to promote the local purpose.\textsuperscript{24} Ultimately, the court determines whether the justification for the state action outweighs the burden imposed on interstate commerce.\textsuperscript{25} 

\textsuperscript{22} See Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366, 381 (1976) (Mississippi statute barring out-of-state products unless the seller's state accepted Mississippi products was struck down because the statute had the effect of cutting off markets to businesses which could produce the produce more efficiently); Pike v. Bruce Church, Inc., 397 U.S. 137, 138-44 (1970) (Arizona statute requiring all cantaloupes offered for sale to be packaged within the state in order that the name of the state packaging the fruit would appear on the container struck down because the statute had the effect of economically enhancing Arizona growers' reputation at the expense of out-of-state packagers); Polar Ice Cream & Creamery Co. v. Andrews, 375 U.S. 361, 375-77 (1964) (Florida statute forbidding the sale of certain milk grades struck down because the statute had the effect of favoring in-state producers); Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1951) (Madison, Wisconsin ordinance requiring any milk sold to be processed and bottled within a five mile radius was struck down because the ordinance had the effect of protecting the local industry from competition); Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 521-22 (1935) (New York statute barring importation of milk purchased at less than the New York minimum price struck down because the resulting effect precluded the natural advantages of out-of-state businesses). These cases all dealt with state action that had the effect of economically protecting in-state interests from competition.

In addition, the Court in Pike v. Bruce Church, Inc., 397 U.S. 137 (1970), "viewed with particular suspicion state statutes requiring business operations to be performed in the home state that could more efficiently be performed elsewhere. Even where the State is pursuing a clearly legitimate local interest, this particular burden on commerce has been declared to be virtually per se illegal." Id. at 145. Bruce Church, Inc., a California company, did not have facilities to package the fruit in Arizona and would have had to expend $200,000 to comply with the statute. Id. at 144. See Toomer v. Witsell, 334 U.S. 385 (1948) (South Carolina statute requiring all shrimp caught off its coast to be unloaded, packaged and stamped in-state); Foster-Fountain Packing Co. v. Haydel, 278 U.S. 1, 10 (1928) (Louisiana statute requiring all shrimp exported to have the heads and shells removed within the state).

\textsuperscript{23} See Dean Milk Co. v. City of Madison, 340 U.S. 349, 353 (1951) (local health ordinance regulating milk processing); South Carolina Hwy. Dep't v. Barnwell Bros., 303 U.S. 177, 189 (1938) (state safety statute regulating truck weight maximum); Mintz v. Baldwin, 289 U.S. 346, 349-50 (1933) (state health statute regulating the importation of cattle). Conservation of resources can also be a legitimate local purpose but the restriction on the resource must be evenhanded and not discriminate against out-of-state interests. See notes 32-33 and accompanying text infra.

\textsuperscript{24} The Court found less burdensome alternatives to exist in Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366, 375-78 (1976) (Mississippi could have applied its own milk inspection standards rather than imposing a restrictive reciprocal condition), and Dean Milk Co. v. City of Madison, 340 U.S. 349, 354-55 (1951) (Madison could have sent health inspectors to milk pasteurizing plants rather than forbid the sale of milk by out-of-state producers).

The application of the balancing test was recently reaffirmed by the Supreme Court in *Hughes v. Oklahoma.*26 In *Hughes,* a state statute27 prohibited the transportation of "natural minnows" for sale out-of-state.28 A commercial minnow dealer located out-of-state was arrested for violating the statute.29 Upholding the out-of-state dealer's commerce clause challenge to the statute, the Court held that the state action failed to meet the requirements of the balancing test. First, the Court determined that the state action was not evenhandedly applied because the statute did not impose the same restrictions on in-state businesses' use of natural minnows.30 Next, the Court decided that the state action purposefully discriminated against interstate commerce because out-of-state interests were *completely barred* from transporting natural minnows for sale out-of-state.31 Third, although a legitimate state interest in conserving local resources was present, the Court recognized that the state action was not the least discriminatory alternative possible.32 Because the statute allowed sale or use of natural minnows in-state, the Court decided that conservation goals could better be served if a non-discriminatory alternative were instituted.33 Consequently, the Court held that the statute's complete bar to interstate commerce violated the commerce clause because the state action failed under all stages of analysis.

**Market Participant Exception to the Balancing Test**

Although scrutiny under the commerce clause generally did not distinguish the form or nature of state action,34 an exception existed for state action in the form of actual participation in the market. Recently, the Supreme Court determined that the balancing test would not be applied if the state through participation in the market merely burdened, but did not totally restrict, interstate commerce.35 The Court established this "market participant exception" to the balancing test in *Hughes v. Alexandria Scrap Corp.*36 In *Alexandria Scrap,* Maryland had instituted a bounty program37 to rid the state of abandoned auto-

28. 441 U.S. at 324. The Court's review of the statute focused on natural minnows because there was no restriction on the sale of hatchery minnows. Okla. Stat. tit. 29, §4-115(B)(2) (Supp. 1978).
29. 441 U.S. at 324.
30. Id. at 336-37.
31. Id.
32. Id. at 337-38.
33. Id.
34. See note 6 and accompanying text supra.
35. See notes 36-52 and accompanying text infra.
In order to reduce bounties paid for "hulks" abandoned outside state boundaries, Maryland required title documentation for all abandoned vehicles including hulks. Maryland also required more burdensome title documentation from out-of-state businesses. Maryland's bounty program reduced the flow of hulks supplied to out-of-state processors and increased the supply to in-state processors. Appellee challenged the program as an impermissible burden on interstate commerce.

The Court held that Maryland's statute did not violate the commerce clause. Reasoning that the purpose of the commerce clause was to prevent state lines from becoming trade barriers to market forces, the Court decided that Maryland's direct participation in the market did not erect any trade barriers "of the type forbidden by the Commerce Clause." As a result, the Court determined that the purpose of the commerce clause did not prohibit state market participation that favored its own citizens. Alexan-

38. 426 U.S. at 796. To facilitate the purpose of the program Maryland paid a bounty to any scrap processor who could prove title to an abandoned vehicle. Id. at 797-98.
39. "Hulks" are defined in the Maryland statute as inoperable vehicles over eight years old. Id. at 799 n.8.
40. Id. at 804-05. Appellee, a Virginia scrap processor located in close proximity to Maryland, participated in the program. Id. at 799.
42. The Maryland processors needed only to submit an indemnification agreement for the bounty payment. This agreement protected the processor from any third-party claim because the hulk supplier promised to indemnify the processor for any claim presented. These indemnification agreements were provided as a matter of course in the business. 426 U.S. at 800-01. The out-of-state processors, on the other hand, had to provide documentation equal to that required for abandoned vehicles. The required documentation included a certificate of title, a certificate vesting title from the police, a bill of sale, or a Wrecker's Certificate if a licensed wrecker. Id. at 801.
43. The Alexandria Scrap Court noted:
   The [statute] did not accomplish this effect directly... It still was possible for licensed non-Maryland processors to receive bounty-eligible hulks from unlicensed Maryland suppliers. But because it was significantly easier for those suppliers to obtain an enhanced price from Maryland processors, they tended to deliver inside the State. The practical effect was substantially the same as if Maryland had withdrawn altogether the availability of bounties on hulks delivered by unlicensed suppliers to licensed non-Maryland processors. Id. at 803 n.13.
44. The Court stated that Maryland's statute was not the kind of action with which the commerce clause is concerned. Id. at 805.
45. The Court recognized that the commerce clause was based on the concept of the Nation as "a common market in which state lines cannot be made barriers to the free flow of both raw materials and finished goods in response to the economic laws of supply and demand." Id. at 803. See Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366, 370-71 (1976). In Cottrell, the Court stated that its analysis of the challenged state action began from this historical purpose. Id.
46. 426 U.S. at 806. The Court characterized the bounty program to be the purchasing of a potential article of interstate commerce. Id.
47. Id. at 809-10.
48. Id. The Court left unanswered the question of whether Congress could legislate against this type of state action under the commerce clause. The Court emphasized that its decision dealt only with implied restraints on state action under the commerce clause. Id. at 810 n.19.
REEVES recognized that the balancing test was generally used to analyze the constitutionality of state action in the form of laws, restrictions, or regulations that restricted or prohibited market interaction between private parties. In Alexandria Scrap no state action of that type was involved because the state apparently had entered the market as a purchaser to rid the state of abandoned automobiles. The Court decided not to apply the balancing test because the state action did not prohibit or restrict the flow of abandoned vehicles between in-state suppliers and out-of-state processors. Rather, interstate commerce was burdened merely by the increased costs the out-of-state processors had to incur to meet the title documentation requirements. Maryland's program never closed the border to out-of-state processors, but only rendered it financially more rewarding for suppliers to deal with in-state businesses. The Court concluded that this effect was the product of sound business judgment between private parties. Thus, although the state market participation burdened the flow of interstate commerce, the absence of any state maintained trade barriers precluded the use of the balancing test.

FACTS AND PROCEDURE OF REEVE'S

In 1919, South Dakota built a cement plant to relieve regional cement shortages. The South Dakota Cement Commission was established to manufacture and distribute the cement. The state owned and operated plant was the only cement plant in the commercial area. It soon produced more than enough cement to meet South Dakota's needs. Between 1970 and 1977 almost half of the plant's output was purchased by out-of-state buyers. In 1978, as demand for cement increased beyond the plant's capacity, South Dakota enforced a resident preference policy. In times of cement shortage, the
The state cement plant commission is hereby empowered and authorized to operate the South Dakota state cement plant located at Rapid City, South Dakota, to sell the products produced at said plant, to fix the price of such products and to determine the manner and methods of the terms under which such products shall be sold, to advertise such products to the public in such manner as the commission shall deem proper, and to do all things in the operation of such plant and the sale of its products as the commission may deem necessary or expedient to the successful operation of said plant.


57. 447 U.S. at 432-33.
58. Petitioner's Brief for Certiorari at 22.
59. 447 U.S. at 432. Cement is a ground mineral product that is mixed with water, sand, gravel and stone to form concrete. Ready-mixed cement is mixed at a central location and distributed in special trucks. Id. at 432 n.2.
60. Id. at 433.
61. Id. Reeves could not obtain another cement supply due to the prohibitive transportation costs of obtaining it from manufacturers east of the Mississippi River. Record at 21-22, Reeves, Inc. v. Stake, 447 U.S. 429 (1980).
62. 447 U.S. at 433.
64. Petitioner's Brief for Certiorari at app. 16.
65. Reeves, Inc. v. Kelley, 586 F.2d 1230 (8th Cir. 1978).
67. 586 F.2d at 1232.
as a market supplier, could favor its own citizens and businesses. The Supreme Court thereafter granted Reeves' petition for certiorari to consider the validity of South Dakota's proprietary activity under the commerce clause. The Court affirmed the decision of the court of appeals and held that South Dakota's resident preference policy did not violate the commerce clause.

THE Reeves Decision

The Court began its analysis with a discussion of Hughes v. Alexandria Scrap Corp., and reaffirmed that state market participation is distinguishable from state market regulation. Having determined that South Dakota fit the market participant label set forth in Alexandria Scrap, the Court in Reeves reasoned that the resident preference program should not be subject to commerce clause scrutiny under the balancing test. The Reeves Court explained that the commerce clause was primarily aimed at taxes and regulations that impede private trade. The Court noted there had been no historical development under the commerce clause that would prohibit the state itself from operating freely in the market. The Reeves Court deter-

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69. Reeves, Inc. v. Kelley, 603 F.2d 736, 738 (8th Cir. 1979). The appeals court distinguished Hughes v. Oklahoma, 441 U.S. 322 (1979), because Oklahoma's prohibition of the shipping and sale of natural minnows was a restriction of privately owned articles of trade, not a proprietary marketing decision. 603 F.2d at 738. On remand, the court of appeals stated that its prior decision was not based on any state controlled natural resource. Id. at 736-37. This determination implies the Reeves Court thought production of cement might be a natural resource to be protected from arbitrary state control.

70. 444 U.S. 1031 (1980).


72. 426 U.S. 794 (1976). The Court stated that Alexandria Scrap did not involve "the kind of action with which the Commerce Clause is concerned." 447 U.S. at 435 (quoting Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 805 (1976)). Maryland's action, according to Reeves, was unlike prior state laws that inhibited interstate commerce because Maryland, in effect, acted as a purchaser. Because Maryland was a market participant and not a market regulator, the Alexandria Scrap Court did not require the state to justify its action. Id. at 435-36. As a result, the Reeves Court interpreted the Alexandria Scrap rule to be that "[n]othing in the purposes animating the Commerce Clause prohibits a State, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others." Id. at 436 (footnotes omitted) (quoting Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 810 (1976)).

73. 447 U.S. at 436. The Court reasoned that "[t]he basic distinction between . . . States as market participants and States as market regulators makes good sense and sound law." Id.

74. The Court determined that the balancing test was not a proper means of review because the general rule of Alexandria Scrap applied. Id. at 440. See note 72 supra.

75. 447 U.S. at 437 (citing Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 807-08 (1976), and H.P. Hood & Sons v. Du Mond, 336 U.S. 525, 539 (1949)). The Hood decision involved a New York statute regulating the licensing of a private milk producer in New York. The Court held that the regulation impeded private trade. 336 U.S. at 545.

mined that a reasoned balancing of interests in this area would better be left to Congress, because of the complex and competing considerations of state sovereignty, the proprietary role of the state as guardian of its people, and the right of private business to deal with whom it pleased.

1972) (statute requiring all public printing needed by Florida to be done in-state did not violate the commerce clause), aff'd mem., 409 U.S. 904 (1972); City of Phoenix v. Superior Court, 109 Ariz. 533, 535, 514 P.2d 454, 456 (1973) (statute granting contractors who paid local taxes 5% bid allowance was not violative of the commerce clause); Holland v. Bleigh Constr. Co., 61 Ill. 2d 258, 274-75, 335 N.E.2d 469, 479 (1975) (statute requiring in-state laborers be given preference for public work projects held permissible).

77. 447 U.S. at 439. The Court explained that "as this case illustrates, the competing considerations in cases involving state proprietary action often will be subtle, complex, politically charged, and difficult to assess under traditional Commerce Clause analysis." Id. The Court also recognized that the activity South Dakota was involved in was subject to congressional legislation under the commerce clause. Id. See, e.g., National League of Cities v. Usery, 426 U.S. 833, 854 n.18 (1976) (areas not deemed to be traditional governmental activities still open to congressional legislation under the commerce clause); New York v. United States, 326 U.S. 572, 574 (1946) (New York state was subject to congressional legislation under the commerce clause when it sold mineral water from springs that the state owned and operated). Given this precedent, the Court suggested that state proprietary activity should also be free from the implied restraints of the commerce clause just as private businesses are. See, e.g., Collins v. Senatobia Bank Book & Stationery Co., 115 Miss. 254, 260, 76 So. 258, 260 (1917) (state statute requiring that contracts for books and stationery be given only to residents held valid under the commerce clause); Tribune Printing & Binding Co. v. Barnes, 7 N.D. 591, 597, 75 N.W. 904, 906 (1898) (statute requiring all county printing to be done within the state upheld under a commerce clause challenge).

78. 447 U.S. at 438. In Reeves, the Court did not base its decision entirely on the market participant exception of Alexandria Scrap. The Court asserted that judicial review of state action which is proprietary in nature must be restrained. The Court cited as authority for this restraint the decision in National League of Cities v. Usery, 426 U.S. 833 (1976). In that case, the Court held that the commerce clause did not allow federal legislation to impede traditional governmental functions. Id. at 852. The state had a right to make and structure employment relationships in the areas of police protection, sanitation, and fire protection. "These activities are typical of those performed by state and local governments in discharging their dual functions of administering the public law and furnishing public services." Id. at 851. Because congressional legislation based on the commerce clause was prohibited in areas of traditional state governmental functions, the Reeves Court concluded that judicial use of the implied restraints of the commerce clause also were inapplicable in those traditional areas. 447 U.S. at 438 n.10.

79. 447 U.S. at 438. In Atkin v. Kansas, 191 U.S. 207, 220-24 (1903), the Court held that a state had the right to hire employees from its citizenry without violating the commerce clause. Id.

80. The Reeves Court stated that "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" has long been recognized. 447 U.S. 438-39 (quoting United States v. Colgate & Co., 250 U.S. 300, 307 (1919)). The Court noted that a state participating in the marketplace has characteristics of both a political and private entity. 447 U.S. at 439 n.12. Cf. Perkins v. Lukens Steel Co., 310 U.S. 113, 127 (1940) (the government has the power to make needed purchases). While acknowledging that the Perkins principle was not absolute, the Reeves Court noted that the similarities of a public entity and a private business acting in the marketplace were significant. 447 U.S. at 439 n.12.
The Court in Reeves conceded that the market participant exception was not absolute; however, it rejected Reeves' five arguments for departure from Alexandria Scrap. First, Reeves argued that the benefits South Dakota had received from selling the cement plant's surplus output in the interstate market should have precluded South Dakota's ability to withdraw from the interstate market when a shortage arose. The Court determined that to accept this market exploitation claim would be tantamount to preventing the state from dealing exclusively with its own residents from the inception of the cement plant. The Court reasoned that this result was unacceptable because it would limit a state's ability to structure new relationships with its own citizens and would thwart novel state programs designed to solve local problems. Second, Reeves claimed that the resident preference program was designed to promote the improper protectionist objective of shielding in-state distributors from out-of-state competition. The Court determined that South Dakota could limit the benefits of the state program because in-state interests funded the cement plant. Third, Reeves argued that cement should be classified as a protected natural resource under the commerce clause because the regional supply of cement was insufficient to meet demand. Dismissing Reeves' argument, the Court explained that cement was not a natural resource but rather the end product of a complex manufacturing process. South Dakota had not limited the access to raw materials used to produce cement because out-of-state interests remained free to purchase any of those materials. Accordingly, the Court concluded that South Dakota had not impermissibly hoarded any natural resource. Fourth, Reeves claimed that an improper competitive advantage had been given to in-state distributors because they could resell the cement out-of-state. The

81. 447 U.S. at 440. Although Reeves admitted the possibility that the market participant exception had limits, the Court did not set forth which factors might cause it to depart from the rule of Alexandria Scrap. See note 72 supra.

82. 447 U.S. at 440.

83. Id. at 440-41. The Court in Reeves explained that a similar argument had been presented in Alexandria Scrap. Id. If a state could limit any benefits to out-of-state interests from the inception of the state market activity, allowing out-of-state interests some benefits did not preclude subsequent in-state preference. Id.

84. Id. at 441.


86. 447 U.S. at 442.

87. Petitioner's Brief for Certiorari at app. 29. If South Dakota could favor its own citizens in the sale of cement, other states could also restrict their market interaction with out-of-state interests in similar circumstances. Id. See, e.g., Baldwin v. Montana Fish & Game Comm'n, 436 U.S. 371, 385-86 (1978) (hoarding of commodities and resources would lead to retaliatory embargoes between states).

88. 447 U.S. at 443-44.

89. Id. at 444. The Court noted that the competitive advantage given to in-state distributors because of their ability to resell out-of-state was a permissible result. Any premium collected by the in-stater equated to the increased cost of purchasing through a middleman. This result compensated South Dakota for the risk it faced building the cement plant. Id. at 444 n.17.
Court noted that Reeves’ position necessarily implied that South Dakota’s program would have been unobjectionable if out-of-state sales from in-state businesses were totally barred. In rejecting Reeves’ argument, the Court explained that such a complete bar on out-of-state sales by private businesses would have amounted to an even greater degree of protectionism than existed under South Dakota’s resident preference program. Finally, Reeves argued that because South Dakota had replaced normal free market forces by its participation in the market, it should have acted in such a manner as to “replicate how the free market would have operated under [the] prevailing conditions.” The Court dismissed this claim as South Dakota had constructed its plant only because the private market had failed to supply the region with cement. South Dakota could not possibly reproduce conditions in a market that would not have existed but for South Dakota’s own participation.

In conclusion the Court stated that any force in Reeves’ arguments for reversal were offset by the possible chilling effect on future state market activity. If South Dakota’s program were invalidated, the Court found unacceptable the resulting disincentive to states to institute similar projects that provided benefits to an entire region.

Analysis and Criticism

The core of the Reeves holding is the determination that South Dakota’s resident preference policy fell within the purview of the market participant

90. Id. at 444-45.
91. Id. at 446. See, e.g., K.S.B. Technical Sales Corp. v. New Jersey Dist. Water Supply Comm’n, 75 N.J. 272, 298, 381 A.2d 774, 787 (1977) (as the burden on interstate commerce increases, commerce clause scrutiny should not decrease). The Court, in rejecting Reeves’ competitive advantage claim, attributed some of Reeves’ difficulty to its not having a long term contract with South Dakota. 447 U.S. at 445. The Court’s position did not consider that Reeves challenged South Dakota’s ability to supply in-state distributors first who also did not have long term contracts.
92. 447 U.S. at 445. Reeves argued that South Dakota’s replacement of the free market should dictate that it act as a private manufacturer and allow market forces to generate the supply and demand for all cement distributors in the region. Id.
93. Id. at 445-46. See, e.g., Eaken v. South Dakota Cement Comm’n, 44 S.D. 268, 272, 183 N.W. 651, 652 (1921) (the private market’s failure to supply an adequate amount of cement delayed both public and private projects).
94. 447 U.S. at 446.
95. Id. The Court noted that the risks involved in state proprietary activity were not insignificant. For example, South Dakota had lost nearly $500,000 in two similar state projects. Id. at 446 n.19.
96. In attacking the majority decision, the dissent emphasized that the commerce clause was designed to prevent exactly this type of economic protectionism. Id. at 447 (Powell, J., dissenting). Justice Powell’s definition of “protectionism” did not include the subsidy program at issue in Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976). 447 U.S. at 447 n.1 (Powell, J., dissenting). South Dakota’s participation in the market allowed it to restrict cement sales for public needs but should not have allowed it to restrict cement sales for the private benefit of its own citizens and businesses.
exception previously established in Hughes v. Alexandria Scrap Corp.\textsuperscript{97} Moreover, the Court in Reeves reasoned that South Dakota “fit the ‘market participant’ label more comfortably”\textsuperscript{98} than Maryland did in the prior decision. The Reeves Court considered Maryland’s action in Alexandria Scrap to be market participation in effect because Maryland acted as a market purchaser by supplying a subsidy to in-state processors. More like a true participant, the state of South Dakota actually participated in the market, and was the only commercially reasonable source of cement in the area. Without any substantive analysis of the effect of South Dakota’s participation on the market, and especially on out-of-state cement purchasers, the Reeves Court summarily concluded that “the general rule of Alexandria Scrap plainly applie[d].”\textsuperscript{99} This determination necessarily implied that the reason for applying the market participant exception was the same in both decisions.\textsuperscript{100} An analysis of the effect of South Dakota’s participation in the market, however, makes it clear that the Court improperly applied the market participant exception because the basis for the exception was absent in Reeves.

The market participant exception adopted in Alexandria Scrap was predicated on two factors. First, state action must be in the form of participation...
in the market. Second, the effect of state action must not be to erect the type of trade barriers forbidden under the commerce clause. If these two requirements are met, the commerce clause does not require the state to justify the resulting burden its action may produce on interstate commerce. Nothing in the commerce clause prevents the state from favoring its own citizens.

In Reeves, however, the Court determined the basis for the market participant exception by analyzing only the first factor outlined in Alexandria Scrap. Accordingly, the Court held that if the state action fit the market participant label, the general rule established in Alexandria Scrap would apply and the Court need not address the second factor. The Court inferred that both of the factors actually determined to be present in Alexandria Scrap were also present in Reeves, without actually making such a determination. This conclusion is difficult to accept because the Reeves Court never considered whether the substantive effect of South Dakota's action did erect the type of trade barriers forbidden under the commerce clause. The Court did not analyze the substantive effect because, in fact, such an analysis would have revealed precisely the type of prohibited trade barrier that could not be justified under the market participant exception of Alexandria Scrap.

In Reeves, the private market interaction was between the in-state cement producer and the in-state or out-of-state cement distributors. The resident preference policy implemented in 1978 changed the relationship between the in-state producer and the out-of-state distributors. The market participants were no longer free to interact across state lines. South Dakota's action totally prohibited out-of-state distributors from purchasing cement from the cement plant.

Unlike the state of Maryland in Alexandria Scrap, which did not totally prohibit market interaction between in-state and out-of-state interests, South Dakota in Reeves effectively barred any market interac-

101. 426 U.S. at 806. See note 46 supra.
102. See notes 49-52 and accompanying text supra.
103. See note 48 and accompanying text supra.
104. See notes 97-99 and accompanying text supra.
105. The Reeves Court stated that its analysis consisted of "a single inquiry: whether the challenged 'program constituted direct State participation in the market.' " 447 U.S. at 435-36 n.7.
106. In Reeves, the Court interpreted the Alexandria Scrap finding of the absence of an impermissible burden to mean that any burdens imposed on private businesses by state market participation were trade barriers for purposes of commerce clause review. Id. This interpretation refutes the Alexandria Scrap conclusion that no trade barriers of the type typically forbidden by the commerce clause resulted from Maryland's participation in the market. See notes 45-52 and accompanying text supra.
107. The Reeves Court's misapplication of the Alexandria Scrap market participant exception is supported by the Court's insistence on equating the burdens on interstate commerce due to South Dakota's policy with barriers to trade between private parties. 447 U.S. at 435-36 n.7.
108. "South Dakota has shut off its cement sales to customers beyond its borders. That discrimination constitutes a direct barrier to trade. . . ." Id. at 453 (Powell, J., dissenting).
109. The out-of-state processors were not precluded from purchasing hulks from the in-state suppliers. See note 43 supra.
tion between the out-of-state distributors and the in-state producer. Given this, the Court should have analyzed the resulting burden to interstate commerce under the balancing test.

The Balancing Test Applied To Reeves

The Right of Out-of-State Business to Compete with In-State Interests

When a state erects a trade barrier between market participants, the Court has traditionally scrutinized the justification for the state action. South Dakota, by enforcing the resident preference policy, gave a competitive advantage to any in-state distributor. A distributor located in-state could purchase cement from South Dakota and then sell it outside the state. Reeves and all other out-of-state cement distributors would not be able to compete for that business. But, if Reeves had relocated within South Dakota, it would also have been at a competitive advantage. This form of burden that reduces the efficiency of business operations because of the need to relocate is strictly scrutinized.

The Reeves Court dismissed as insignificant the competitive advantage afforded in-state distributors. The Court stated that South Dakota could have enforced a greater amount of protection by totally barring out-of-state sales after 1920, thereby rendering Reeves' competitive advantage claim unobjectionable because any sale to out-of-state businesses would be less burdensome on interstate commerce. This argument assumed a vital factor under the balancing test which the Court had not recognized in prior cases when testing state action. Previously, the extent of the burden on

110. The Court in Reeves noted that South Dakota had not completely cut off out-of-state distributors because they could purchase cement from other in-state distributors in the secondary market. 447 U.S. at 444 n.17. This reasoning, however, misinterpreted the Alexandria Scrap Court's determination of the parties which are protected from having trade barriers erected against them. In Alexandria Scrap, the out-of-state purchaser was not precluded from purchasing from the in-state supplier. See note 52 supra.

111. See notes 15-18 and accompanying text supra.

112. 447 U.S. at 444 n.17. Out-of-state buyers will pay an increased price that in-state distributors will not pay. Id. As a result, the state action did not have an evenhanded effect on in-state and out-of-state interests. See note 19 and accompanying text supra.

113. This result has the practical effect of discriminating against out-of-state interests. Accordingly, the second stage in the balancing test was present. See notes 20-22 and accompanying text supra.

114. Reeves noted this result after the resident preference policy was implemented. 447 U.S. at 445.

115. See Pike v. Bruce Church, Inc., 397 U.S. 137, 142-44 (1970) (state statute requiring fruit to be packaged in closed containers within the state forced out-of-state fruit packagers to relocate packaging facilities in-state); Toomer v. Witsell, 334 U.S. 385, 395 (1948) (state statute requiring all shrimp caught off its coast to be unloaded, packaged, and stamped within the state forced out-of-state shrimp suppliers to relocate); Foster-Fountain Packing Co. v. Haydel, 278 U.S. 1, 10 (1928) (state statute requiring all shrimp exported to have heads and shells removed within the state was unjustifiable economic burden to out-of-state shrimp suppliers).

116. See note 91 supra.
interstate commerce was scrutinized after the state erected a trade barrier between private parties.\textsuperscript{117} In \textit{Reeves}, the Court analyzed the hypothetical burden imposed from the inception of the cement plant in 1920. Since South Dakota theoretically could have prohibited out-of-state sales from the beginning, the Court reasoned that the sale of any cement to out-of-state businesses had a less burdensome impact on interstate commerce. Under the Court's reasoning, the operation of the cement plant in 1920 was the barrier to trade to which commerce clause scrutiny would be applied.\textsuperscript{116} In fact, however, there was no trade barrier erected before 1978 because South Dakota had not limited the right of out-of-state businesses to compete with in-state interests. Thus, the \textit{Reeves} Court's, position that no impermissible competitive advantage was given to in-state distributors is not well founded. The existence of the discriminatory competitive advantage should have triggered the third stage of the balancing test.

After the discriminatory effect of the state action is established, the state must prove the existence of a legitimate local purpose.\textsuperscript{118} The Court in \textit{Reeves} decided that in-state purchasers should have the right to the cement output first because they incurred the possible risk of loss in the cement plant operation.\textsuperscript{120} Under the balancing test the state must also prove the absence of less restrictive alternatives to protect the claimed local benefit.\textsuperscript{121} A possible alternative would have been to ration the available supply to all cement distributors. This measure would equalize the burden of the short supply to all distributors purchasing from the cement plant.\textsuperscript{122} Since the \textit{Reeves} Court did not address this alternative, it can be inferred that the Court reasoned that no less restrictive alternatives existed. In addition, the third stage of the balancing test requires the Court to weigh the burden imposed on interstate commerce against the state justification for the burden.\textsuperscript{123} The \textit{Reeves} Court failed to recognize the burden imposed by the competitive advantage given to in-state distributors;\textsuperscript{124} as a result, it is evident that if the balancing test had been applied, its requirements would not have been met.

\textsuperscript{117} See, e.g., Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366, 375 (1976) (burden imposed on interstate commerce was measured after the Court determined Mississippi's statute had blocked trade between out-of-state producers and in-state buyers); Dean Milk Co. v. City of Madison, 340 U.S. 349, 355 (1951) (burden imposed by local ordinance evaluated after the discrimination arose between in-state buyers and out-of-state sellers).

\textsuperscript{118} 447 U.S. at 444-45. The \textit{Reeves} Court relied on \textit{Pike v. Bruce Church, Inc.}, 397 U.S. 137 (1970), in support of the absence of a competitive advantage for in-state distributors. In \textit{Pike}, however, the Court did not scrutinize the extent of the burden until the barrier to trade was erected. \textit{Id.} at 142-44.

\textsuperscript{119} See note 23 and accompanying text supra.

\textsuperscript{120} 447 U.S. at 446 n.19. See note 95 supra.

\textsuperscript{121} See note 24 and accompanying text supra.

\textsuperscript{122} Another alternative would be to ration the available supply to all distributors with a premium quantity given to in-staters.

\textsuperscript{123} See note 25 and accompanying text supra.

\textsuperscript{124} See notes 111-118 and accompanying text supra.
The Right of Out-of-State Businesses to Equal Access to In-State Natural Resources

Under the commerce clause, the balancing test is also used to determine if a state has impermissibly hoarded a natural resource.\(^{125}\) The Reeves Court sought to characterize South Dakota's resident preference policy as not involving the hoarding of any natural resource. It was true that South Dakota had not restricted the private sector's access to the materials used in cement production.\(^{126}\) Although cement is not a natural resource,\(^{127}\) the South Dakota plant, through the manufacturing process, produced a product that was a scarce resource within its region.\(^{128}\) This circumstance in Reeves bore a striking similarity to two prior decisions\(^{129}\) which suggest that the Court should have scrutinized Reeves' claim to equal access to the available cement supply. In City of Philadelphia v. New Jersey,\(^{130}\) the Court struck down New Jersey's attempt to restrict out-of-state use of in-state landfill sites. The discriminatory prohibition forced out-of-state interests to bear the burden of the entire effect of the regulation.\(^{131}\) Similarly, Reeves and other out-of-state distributors were forced to absorb the entire effect of the short supply of cement in 1978. In Pennsylvania v. West Virginia,\(^{132}\) the Court invalidated a West Virginia statute forcing all natural gas producers located in West Virginia to give preference to in-state customers. In Reeves, the resident preference policy had the same effect; South Dakota's action forced the cement producer to give preference to all in-state customers.\(^{133}\)

Under the balancing test, South Dakota's resident preference policy would have been struck down. First, the policy was not applied evenhandedly; in-state distributors were favored.\(^{134}\) Second, the state action purposefully discriminated against out-of-state businesses because they were totally}

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126. 447 U.S. at 443-44.
127. The Reeves Court stated that coal, timber, wild animals, and minerals were natural resources, but that cement was not. Id. at 443.
128. See, e.g., Pennsylvania v. West Virginia, 262 U.S. 553, 596-99 (1923) (natural gas production is a resource to be protected from hoarding under the commerce clause); West v. Kansas Natural Gas Co., 221 U.S. 229, 255-56 (1911) (same).
129. See notes 130-133 and accompanying text infra.
131. Id. at 622-24.
132. 262 U.S. 553 (1923).
133. Justice Powell noted this result by stating that "[t]he effect on interstate trade is the same as if the state legislature had imposed the policy on private cement producers." 447 U.S. at 453 (Powell, J., dissenting).
134. The shortage of supply was so acute that out-of-state distributors were not able to purchase any cement from the plant. See note 58 and accompanying text supra. Cf. City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978) (only out-of-state waste suppliers precluded from using in-state landfill sites).
barred from purchasing cement from the producer. Third, South Dakota could not claim any legitimate conservation purpose because South Dakota had not limited in-state distributors' freedom to sell cement beyond state boundaries.

To allow South Dakota the discretion to determine who may realize the benefits of cement production is to restrict the economic efficiency of the national market place, regardless of whether South Dakota had not restricted the means to cement production. Because the cement plant was the only manufacturer in the region, it follows that South Dakota was sufficiently supplying the regional market. After the resident preference policy was implemented, out-of-state buyers were forced to wait until another manufacturer supplied the area. Once the seasonal demand diminished, South Dakota would attempt to sell the excess output in the out-of-state market. Similarly, in Pennsylvania v. West Virginia, the state did not limit access to the means of producing a natural gas plant. Out-of-state buyers were not precluded from producing their own natural gas. Moreover, the stricken statute would have forced out-of-state buyers to wait for other natural gas suppliers to open, similar to the delay imposed on out-of-state distributors in Reeves. These types of state action limit the efficiency of the marketplace because state boundaries, rather than supply and demand, become restraints on market interaction.

Impact

The Reeves decision set forth a new standard for judicial use of the implied restraints of the commerce clause. Now, state market participation which creates the same effect as state action prohibiting private market interaction will be scrutinized under a different standard for commerce clause purposes. In Alexandria Scrap, the state action did not require traditional commerce clause scrutiny because the market participation created no trade barriers of the type forbidden. In Reeves, even though a forbidden trade barrier had been erected through state market participation, classification of the state as a market participant was the determining factor which precluded commerce clause scrutiny. Consequently, the two step analysis of the market participant exception adopted by Alexandria Scrap was reduced in Reeves to one step. Courts will now scrutinize state action to determine if it fits the market

136. 447 U.S. at 444.
137. 447 U.S. at 448 n.2 (Powell, J., dissenting).
138. Almost one half of the plant's output was sold to out-of-state distributors before 1978. Id. at 432.
139. See notes 44-52 and accompanying text supra.
140. See notes 97-110 and accompanying text supra.
participant label without determining if the underlying effect of the state action creates a forbidden type of trade barrier. If South Dakota had prohibited a private cement producer from selling to out-of-state buyers, however, the Court would have recognized the forbidden trade barrier and applied the balancing test.41

The new standard adopted by Reeves precludes the application of any balancing test to state market participation activity. In Reeves, the failure to distinguish between forbidden trade barriers and permissible burdens resulting from state market activity leaves future courts without basis for commerce clause scrutiny under the balancing test. Courts cannot use the balancing test because the discriminatory effect of the state action was disregarded in Reeves. The Court did not define the boundaries of the market participant exception, but only stated that the possibility of exceptions existed. As a result, future courts will apply a less restrictive analysis to state action in the form of market participation because the extent of the burdens imposed upon interstate commerce in Reeves would have been impermissible under the balancing test.42

The major impact of the Reeves decision may arise from increased state participation in the market to protect in-state interests. If a state imposes protectionist economic legislation on private parties, commerce clause scrutiny is applicable under the balancing test. Following Reeves, state participation in the market which produces the same effect is, however, immune from commerce clause scrutiny. Under the Reeves decision, a state participating directly in the market for the manufacture, production, and sale of new energy sources, such as oil shale or oil sand, would be able to favor in-state interests during an energy shortage at the expense of out-of-state interests.43 In addition, the state could force out-of-state interests to relocate in-state by differentiating the price of goods sold.44 Similarly, a state involved in the manufacture, production, and sale of pharmaceutical goods could determine who receives the benefit of a new life saving drug by restricting its sale to in-state interests.45 These extreme forms of state protectionist policy are possible after Reeves because of the absence of any limiting criteria to the market participant exception.

Conclusion

Scrutiny of state market participation is now constricted because under the Reeves Court's analysis, the substantive effect of the state action will be disregarded. The Court's interpretation that the form of the state action is conclusive of whether the market participant exception applies, sets forth a

141. 447 U.S. at 453 (Powell, J., dissenting).
142. See notes 111-138 and accompanying text supra.
143. 447 U.S. at 453 n.6 (Powell, J., dissenting).
144. Purchasing Exclusion, supra note 6, at 927.
145. 447 U.S. at 453 n.6 (Powell, J., dissenting).
less restrictive standard for state policies that protect or favor in-state interests when the state is a participant. The traditional balancing test no longer applies because the Reeves Court rejected the basis for its application by expanding the market participant exception. This decision shifts the focus of recent Supreme Court cases in the area of commerce clause scrutiny from the effect of the state action on interstate commerce to the form of state action. This shift will allow states participating in the market to adopt policies that promote economic balkanization. With the Reeves decision, the Court has deferred its right to scrutinize state participation in the marketplace under the commerce clause. The Reeves Court determined that Congress is better equipped than the courts to evaluate the competing interests involved when a state participates in the market.

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