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Setting Parameters on the Market-Participant Doctrine: South-Central Timber Development, Inc. v. Wunnicke {104 S. Ct. 2237}

Stephen R. Roberti

SETTING PARAMETERS ON THE MARKET-PARTICIPANT DOCTRINE: *SOUTH-CENTRAL TIMBER DEVELOPMENT, INC. v. WUNNICKE*

Traditionally, state action affecting interstate commerce is subject to regulation under the commerce clause.[1] States affect commerce in two ways: as market regulators, they prescribe the rules of trade between private parties;[2] and, as market participants, they engage in the market directly as buyers, sellers or employers.[3] Although the commerce clause limits states' regulatory activity affecting commerce,[4] the

1. The commerce clause states, in pertinent part, that "Congress shall have Power . . . To regulate Commerce with foreign Nations and among the several States. . . ." U.S. CONST. art. I, § 8, cl. 3.

2. *See* Note, *Commerce Clause—State Purchasing Activity Excluded from Commerce Clause Review*—Hughes v. Alexandria Scrap Corp., 18 B.C. IND. AND COM. L. REV. 893, 897 n.33 (1977).

3. *Id. See infra* note 16 and accompanying text for a discussion of state proprietary functions.

4. Congress regulates interstate commerce in two ways: 1) through legislation, and 2) implication, otherwise termed the dormant commerce clause. J. NOWAK, R. ROTUNDA & J. YOUNG, HANDBOOK ON CONSTITUTIONAL LAW 243-66 (1978). When state actions affect interstate commerce, the Court employs a balancing test to determine whether the state's activities survive commerce clause limitations:

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

Pike v. Bruce Church, 397 U.S. 137, 142 (1970).

For cases applying the balancing test, see New England Power Co. v. New Hampshire, 455 U.S. 331 (1982) (New Hampshire statute prohibiting exportation of hydroelectric power without state permission is an undue burden on interstate commerce); Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366 (1976) (Louisiana health interest promoted by statute forbidding importation of milk from states not possessing reciprocal sales agreement outweighed by burden imposed on milk distributors in states without reciprocity agreement); Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) (Arizona

Supreme Court, in a recent line of cases,[5] exempted states from commerce clause limitations when they engaged in the market as participants. In *South-Central Timber Development, Inc. v. Wunnicke*,[6] the Court limited a state's ability to use the market-participant exemption by holding that a state's right to directly[7] affect interstate commerce while engaged in proprietary activities does not extend beyond the market in which the state is an immediate[8] participant.

In *South-Central Timber Development, Inc. v. Wunnicke*, Alaska required that state-owned timber receive primary manufacture at in-state mills prior to export.[9] Alaska, neither owning nor operating process-

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statute requiring melons to be packed in-state before exportation held an undue burden on interstate commerce).

5. *See, e.g.*, United Bldg. and Constr. Trades Council v. Mayor of Camden, 104 S. Ct. 1020 (1984) (state as employer); White v. Mass. Council of Const. Employers, 460 U.S. 204 (1983) (state as employer); Reeves v. Stake, 447 U.S. 429 (1980) (state as seller); Hughes v. Alexandria Scrap, 426 U.S. 794 (1976) (state as purchaser).

6. 104 S. Ct. 2237 (1984).

7. *See infra* notes 81-83 and accompanying text for the distinction between a state's direct, versus indirect, effect on commerce as a market participant.

8. A state is an immediate participant in markets in which it has an immediate proprietary interest. For example, South-Central was a participant in the timber-selling market, but was not a participant in the timber-processing market because it owned no processing facilities. In *South-Central*, the Court places restrictions on a state's ability to impose downstream control over goods in which the state no longer has a proprietary interest. A state imposes downstream control whenever it directly restricts the free flow of goods which have passed out of the market in which the state has a proprietary interest. *See* White v. Mass. Council of Const. Employers, 460 U.S. 204, 221 (Blackmun, J., dissenting).

In antitrust law, downstream restraints are known as vertical restrictions and are unlawful. *See* Anson & Schenkkan, *Federalism, The Dormant Clause, and State-Owned Resources*, 59 TEX. L. REV. 71, 77 n.25 (1980). *See also* Jefferson County Pharmaceutical Ass'n. v. Abbott Laboratories, 460 U.S. 150, *reh'g denied*, 460 U.S. 1105 (1983) (state, as purchaser of pharmaceuticals for resale in open market, was subject to federal antitrust law); Limeco, Inc. v. Division of Lime, 546 F. Supp. 868 (N.D. Miss. 1982) (state, as operation of lime-crushing plants, was subject to federal antitrust law). *But see* Transport Limosine v. Port Auth., 571 F. Supp. 576 (E.D.N.Y. 1983) (Port Authority as market participant not subject to federal antitrust laws).

9. ALASKA STAT. § 38.05.115 (1982) grants the Commissioner of the Department of Natural Resources the power "to determine the timber and other materials to be sold, and the limitations, conditions, and terms of sale." Pursuant to § 38.05.115, the Commissioner of the Department of Natural Resources promulgated ALASKA ADMIN. CODE tit. II, § 76.130 (1974) (repealed 1982) (re-authorized at ALASKA ADMIN. CODE tit. II, §§ 71.230, 71.910 (1982)):

> Primary Manufacture: a) The director may require that primary manufacture of logs, cordwood, bolts or other similar products be accomplished within the State of Alaska. b) The term primary manufacture means manufacture which is first in

ing mills, instituted the primary manufacture rule to protect the state's private timber processing industry.[10] South-Central Timber Development, Inc. purchases and logs timber for export.[11] South-Central wanted to purchase Alaskan timber, but the added cost of in-state primary manufacture made purchase for export impracticable.[12] South-Central challenged Alaska's primary manufacture requirement as a violation of the commerce clause.[13] Alaska responded that because it was selling timber, it was acting as a market-participant and could therefore condition sales of timber upon in-state primary manufacture without being subject to commerce clause scrutiny.[14] The Supreme

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order of time or development. When used in relation to sawmilling, it means 1) the breakdown process wherein logs have been reduced in size by a headsaw to the extent that the residual cants, slabs, or planks can be processed by resaw equipment of the type customarily used in log processing plants; or 2) manufacture of a product for use without further processing, such as structural timbers (subject to a firm showing of an order or orders for this form of product). c) Primary manufacture, when used in reference to pulp ventures, means the breakdown process to a point where the wood fibers have been separated. Chips made from timber processing wastes shall be considered to have received primary manufacture.

The state required the successful bidder to sign a proposed contract, which stated, in pertinent part: "*Section 68. Primary Manufacture.* Timber cut under this contract shall not be transported for primary manufacture outside the State of Alaska without written approval of the State." 104 S. Ct. at 2239 n.1 (quoting proposed contract for sale).

10. The Governor of Alaska issued the following policy statement regarding the sale of timber for primary manufacture:

> It is the policy of the State of Alaska to manage the State's forests on a sustained yield basis; to protect existing industries; to provide for the establishment of new industries, and to derive revenue from all timber resources. The policy of the State of Alaska relative to the export and primary manufacture of timber, [is] within the definition contained in Department Regulations . . . .

Brief for Petitioner at 31a, South-Central Timber Development Co. v. Wunnicke, 104 S. Ct. 2237 (1984) [hereinafter cited as Brief for the Petitioner].

The federal Government has parallel regulations for timber harvested from national forests in Alaska:

> Unprocessed timber from National Forest System lands in Alaska may not be exported from the United States or shipped to other States without prior approval of the Regional Forester. This requirement is necessary to ensure the development and continued existence of adequate wood processing capacity in that State for the sustained utilization of timber from the National Forests which are geographically isolated from other processing facilities.

36 C.F.R. § 223.161 (1984).

11. South-Central Timber Dev. Inc. v. Wunnicke, 104 S. Ct. 2237, 2239 (1984).

12. *Id.* at 2239 n.5.

13. *See* South-Central Timber Dev., Inc. v. LeResche, 511 F. Supp. 139, 141 (D. Alaska 1981).

14. 104 S. Ct. at 2243.

Court rejected that contention and refused to allow Alaska, a participant in the timber-selling market, to regulate activity in the timber-processing market.[15]

The Supreme Court has long recognized that states often participate in the marketplace.[16] Traditionally, states' proprietary activities have only marginally affected interstate commerce.[17] Today, however, states are expanding their proprietary role,[18] and, as a result, litigation

15. *Id.* at 2447. *See infra* note 65 and accompanying text.

South-Central progressed through the lower courts on several legal theories. The district court inferred from dicta in *Reeves* that the market-participant exemption does not extend to state proprietary activity involving natural resources. South-Central Timber Dev., Inc. v. LeResche, 511 F. Supp. 139, 143 (D. Alaska 1981). *See infra* note 33 and accompanying text (discussion of the role of natural resources in determining a market participant exemption). Alaska also argued that because Congress had parallel primary manufacture requirements for timber taken from federal lands, Congress implicitly consented to Alaska's primary manufacture requirement. 511 F. Supp. at 141. The district court rejected this argument, holding that Congress must expressly exempt states from commerce clause restrictions. *Id.*

The circuit court did not consider the market participant issue. Rather, the court held that Congress implicitly consented to Alaska's primary manufacture requirement by virtue of the existence of a parallel federal requirement for timber harvested from national forests. South-Central Timber Dev., Inc. v. LeResche, 693 F.2d 890, 893 (9th Cir. 1982). The court reasoned that "express authorization is not always necessary. There will be instances where the federal policy is so clearly delineated that a state may enact a parallel policy without explicit congressional approval, even if the purpose and effect of the state law is to favor local interests." *Id.*

The Supreme Court rejected the court of appeals' finding of implicit consent, noting that parallel federal and state policies may not be mutually supportive. Congress formulates federal policies with respect to the national interest—each state is represented. State policy, however, is the product of a single state's needs. 104 S. Ct. at 2292. Although the Court stated that "there is talismanic significance to the phrase 'expressly stated,' . . . Congressional intent must be unmistakably clear." *Id.*

16. Since the turn of the century, the Court has recognized that states engage in proprietary functions. *See, e.g.*, Wilmette Park Dist. v. Campbell, 338 U.S. 411 (1949) (municipally operated benches); New York v. United States, 326 U.S. 572 (1946) (state sales of mineral waters); Ohio v. Helvering, 292 U.S. 360 (1934) (state-owned liquor stores); South Carolina v. United States, 199 U.S. 437 (1905) (state-owned liquor stores); Field v. Barber Asphalt Paving Co., 194 U.S. 618 (1904) (state as purchaser of asphalt); Atkins v. Kansas, 191 U.S. 207 (1903) (state determined labor contract conditions); American Yearbook Co. v. Askew, 339 F. Supp. 719 (M.D. Fla.), *aff'd mem.*, 409 U.S. 904 (1972) (state as purchaser of printing services).

17. At the turn of the century, aggregate state expenditures were a relatively minor fraction of the gross national product (GNP). Even by 1929, state government expenditures accounted for less than seven percent of the GNP. *See* Melder, *The Economics of Trade Barriers*, 16 IND. L.J. 127, 139-41 (1940); DEP'T. OF CENSUS, HISTORICAL STATISTICS OF THE UNITED STATES—COLONIAL TIMES TO 1970, PART I, p. 230 (1976).

18. In 1976, state and local expenditures rose to 13% of GNP. While aggregate state expenditures do not show the exact amount spent by all states on proprietary

challenging state proprietary activity as a violation of the commerce clause has become prevalent.[19]

The Supreme Court first considered the special relationship of state proprietary activity to the commerce clause in *Hughes v. Alexandria Scrap Corp.*[20] In *Alexandria Scrap*, Maryland paid a bounty to metal processors to encourage recycling of scrapped automobiles. The bounty scheme discriminated against out-of-state metal processors. It required them to provide more title documentation for automobiles turned in for bounty than was required of in-state processors.[21] The Court held that by paying a bounty in return for scrapped automobiles, Maryland was a purchaser[22] and, thus, was exempt from commerce clause limitations.[23] The *Alexandria Scrap* Court thus created a market-participant exception to the commerce power. That exception per-

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activities, data for just 11 states shows that during 1976, $1.017 billion were spent on proprietary activities. *See* Comment, *In-State Preferences in Public Contracting: States' Rights Versus Economic Sectionalism*, 49 U. COLO. L. REV. 205, 205-11 (1978).

19. *See, e.g.*, Jefferson County Pharmaceutical Ass'n v. Abbott Laboratories, 460 U.S. 150, *reh'g denied*, 460 U.S. 1105 (1983) (state as seller); Western Oil and Gas Assoc. v. Cory, 726 F.2d 1340 (9th Cir. 1984) (state as landlord); Washington State Bldg. & Constr. Trades v. Spellman, 684 F.2d 627 (9th Cir. 1982) (state as trash dump operator); Fidelity Guarantee Mortgage Corp. v. Connecticut Hous. Fin. Auth., 532 F. Supp. 81 (D. Conn. 1982) (state as lender); American Yearbook Co. v. Askew, 339 F. Supp. 719 (M.D. Fla.), *aff'd mem.*, 409 U.S. 904 (1972) (state as purchaser); City of Phoenix v. Superior Court, 109 Ariz. 533, 514 P.2d 454 (1973) (state as purchaser); Holland v. Bleigh Constr. Co., 61 Ill. 2d 258, 335 N.E.2d 469 (1975) (state as employer); Garden State Daries, Inc. v. Sills, 46 N.J. 349, 217 A.2d 126 (1966) (state as purchaser); American Inst. for Imported Steel, Inc. v. County of Erie, 58 Misc. 2d 1059, 297 N.Y.S.2d 602 (Sup. Ct. 1968) (state as purchaser), *modified*, 32 A.D.2d 231, 302 N.Y.S.2d 61 (1969).

20. 426 U.S. 794 (1976).

21. *Id.* at 801-03. Alexander, a Virginia scrap processor, claimed that the effect of this requirement was to burden interstate commerce because in-state hulk suppliers were now less likely to bring their scrapped automobiles to out-of-state processors. *Id.* at 803-04.

22. The Court stated:

> [In cases of market regulation] the State interfered with the natural functioning of the interstate market either through prohibition or through burdensome regulation. By contrast, Maryland has not sought to prohibit the flow of [scrapped automobile] hulks or to regulate the conditions under which it may occur. Instead, it has entered into the market itself to bid up their price. There has been an impact upon the interstate flow of hulks only because, since the 1974 amendment, Maryland effectively has made it more lucrative for unlicensed suppliers to dispose of their hulks in Maryland rather than take them outside the state.

Id. at 806.

23. The Court noted that "[n]othing in the purposes animating the commerce clause prohibits a state, in the absence of congressional action, from participating in the

mitted states trading in the marketplace to decide unilaterally with whom they wish to deal, regardless of the effect on interstate commerce.[24]

The Court affirmed the market-participant doctrine in *Reeves v. Stake*,[25] by holding that a state may restrict the sale of state-owned goods to its residents. In *Reeves*, North Dakota restricted the sale of state-produced cement during periods of shortages to residents only.[26] Although the Court applied the market-participant doctrine to the state as a seller, rather than a purchaser, *Reeves* did not substantially expand upon the doctrine delineated in *Alexandria Scrap*.[27] Nevertheless, *Reeves* outlined the policies underlying the market-participant doctrine[28] and, in dicta, suggested circumstances that may limit the doctrine's application.[29]

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market and exercising the right to favor its own citizens over others." *Id.* at 810. *See also* Note, *supra* note 2, at 924-25.

24. Justices Brennan, White and Marshall vigorously dissented to the amount of freedom the majority would allow to states that qualify as market participants. Rather than categorically exempting states from the strictures of the commerce clause, the dissent would subject all state action affecting interstate commerce to strict scrutiny, except that action which allows a state to effectively function in the federal system. 426 U.S. at 817-30 (Brennan, J., dissenting).

The dissent attacked the majority opinion on a second ground. Commerce clause limitations on state activities affecting interstate commerce are premised on the policy of maintaining a national marketplace. By allowing states to enter the market midpoint in a production stage, they can affect the ultimate distribution of a product for end use. *Alexandra Scrap*, 426 U.S. at 824 (Brennan, J., dissenting). *See* Great Atl. & Pac. Tea Co., Inc. v. Cottrell, 424 U.S. 366, 370-71 (1976). *See also* H.P. Hood v. DeMund, 336 U.S. 525, 539 (1949) ("Our system, fostered by the commerce clause, is that [an individual] shall be encouraged to produce by the certainty that he will have free access to every market in the Nation."); McLead v. Dillworth, 322 U.S. 327, 330 (1940) ("The very purpose of the commerce clause was to create an area of free trade among the several states.").

25. 447 U.S. 429 (1980). The *Reeves* Court stated: "The basic distinction in *Alexandria Scrap* between States as market participants and States as market regulators makes good sense and sound law." *Id.* at 436.

26. In *Reeves*, North Dakota owned and operated a cement manufacturing plant that sold to buyers in at least nine states. 447 U.S. at 432. Petitioner, a nonresident, purchased 95% of his cement from North Dakota. *Id.* In 1978, due to cement shortages, North Dakota restricted the sale of cement to residents only. *Id.* at 433. Petitioner bought suit claiming that North Dakota's restrictive sales policy violated the commerce clause. *Id.*

27. The Court stated that the facts of *Reeves* fit the general rule enunciated in *Alexandra Scrap* better than the facts of *Alexandria Scrap* itself. *See id.* at 440.

28. *See infra* notes 30-32 and accompanying text.

29. *See infra* notes 33-35 and accompanying text.

The *Reeves* Court cited three justifications for exempting states as market participants from commerce clause regulation: (1) state sovereignty,[30] (2) state fiduciary responsibility to its residents,[31] and (3) a state's right to engage in private business free from governmental interference.[32] The Court suggested, however, that the market-participant doctrine does not apply when the state-owned "good" in question is a natural resource[33] or when the state participates in an international market.[34] In these instances, the Court implied that it would scrutinize

30. The *Reeves* court asserted that courts should not interfere with a state's market participation if such interference would impair the state's ability to act in its full sovereign capacity. 447 U.S. at 438 n.10. The Court defined the scope of immunity afforded states through their position as sovereigns in National League of Cities v. Usery, 426 U.S. 833, 852 (1976). In Garcia v. San Antonio Metropolitan Transit Authority, 105 S. Ct. 1005 (1985), the Court reaffirmed the power of states to participate in the market, but abandoned the governmental/proprietary distinction. *Id.* at 1015-16. Instead, the Court determined that state sovereignty is protected by state participation in the political process. *Id.* at 1019-20.

Even though the Court will not review a state's proprietary activity, Congress can regulate such activity by preemption. *Reeves*, 447 U.S. at 439. *See, e.g.*, Pirolo v. City of Clearwater, 711 F.2d 1006, 1008-10 (1983) (federal regulation on noise control supersedes state regulation, even though state may be a market participant).

31. The state, to some extent, acts as a trustee for its residents. *See, e.g.*, Toomer v. Witsell, 334 U.S. 385, 403-06 (1948) (state may ensure development of in-state food supply); Atkins v. Kansas, 191 U.S. 207, 222-23 (1903) (state may restrict work hours for construction employees working on public contracts).

32. The Court suggested that states acting as market participants should receive the same rights as private businesses. 447 U.S. at 439.

33. In *Reeves*, petitioner challenged South Dakota's refusal to sell state-owned cement, claiming that the state denied nonresidents access to its natural resources. *Id.* at 443. Although the Court noted that states could not hoard natural resources, it summarily rejected petitioner's argument by holding cement to be a nonnatural, manufactured good. *Id.* at 444. Other cases reaffirm that state regulation of natural resources is subject to commerce clause scrutiny. *See, e.g.*, Hicklin v. Orbeck, 437 U.S. 518, 533 (1978) (states cannot prefer residents when distributing its natural resources destined for interstate commerce). *See also* Spornhase v. Nebraska, 458 U.S. 941 (1982) (hydroelectric power); New England Power Co. v. New Hampshire, 455 U.S. 331 (1982) (hydroelectric power); Huges v. Oklahoma, 441 U.S. 322 (1979) (minnows); Toomer v. Witsell, 334 U.S. 385 (1948) (shrimp); Foster-Fountain Packing Co. v. Haydel, 278 U.S. 1 (1928) (shrimp); Shafer v. Farmers Grain Co., 268 U.S. 189 (1925) (grain); Pennsylvania V. West Virginia, 262 U.S. 553 (1923) (natural gas); Lemke v. Farmers Grain Co., 258 U.S. 50 (1922) (grain).

The states do, however, have the power to preserve and regulate the exploitation of an important resource. *See* Toomer v. Witsell, 334 U.S. 385, 402 (1948).

34. Although not at issue in *Reeves*, the Court stated that "commerce clause scrutiny may well be more rigorous when a restraint on foreign commerce is alleged." Reeves v. State, 447 U.S. 429, 438 n.9 (1980). *See also* Japan Line Ltd. v. County of Los Angeles, 441 U.S. 434, 454 (1979) (California ad valorem property tax, as applied to

the state's activity closely to determine whether the market-participant exemption should apply.[35]

The dissent in *Reeves*[36] criticized the majority for giving states a free hand to disrupt interstate commerce merely because they pin on the "market-participant" label.[37] The dissent would subject all state action affecting interstate commerce to commerce clause scrutiny, except those actions essential to state sovereignty.[38] The dissent feared that economic balkanization could result from allowing states complete freedom to prefer residents over nonresidents. Such freedom, the dissent argued, would destroy the national marketplace which the commerce clause was designed to protect.[39]

Three years later, in *White v. Massachusetts Council of Construction Employers*,[40] the Supreme Court broadened the range of permissible state activity under the market-participant doctrine. In *White*, the City of Boston required that at least half of the workers on all construction projects funded, in whole or in part, by city funds, or funds administered by the City, be Boston citizens.[41] The Boston work order effectively regulated employment contracts between private contracting

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Japanese shipping companies' cargo containers, held unconstitutional under the commerce clause); Bethlehem Steel Corp. v. Bd. Comm'rs, 276 Cal. App. 2d 221, 225, 80 Cal. Rptr. 800, 802 (1969) ("Buy American" statute held subject to commerce clause). *But see* K.S.F. Technical Sales Corp. v. North Jersey Water Supply Comm'n., 75 N.J. 272, 293-302 (1977) ("Buy American" statute held not subject to commerce clause when state is market participant).

35. 447 U.S. at 438 n.9.

36. Justice Powell wrote the dissenting opinion; Justices Brennan, White and Stevens joined. 447 U.S. at 447 (Powell, J., dissenting).

37. *Id.* at 447-54.

38. The dissent would subject both proprietary and regulatory state activities to commerce clause scrutiny unless the activities reviewed were integral to maintaining state sovereignty. The dissent argued that although states may function in the private sector it is precisely because states are states, with fiduciary and sovereign obligations, that they "cannot be presumed to act like an enterprise engaged in entirely private business." *Id.* at 449-50.

39. 447 U.S. at 453-54. *See supra* note 24 (discussion of the purposes underlying the commerce clause).

The dissent feared that states would restrict sales of state-produced commercial necessities to residents only: "Since the Court's decision contains no limiting principles, a state will be able to manufacture any commercial product and withhold it from citizens of other States. This prerogative could extend, for example, to pharmaceutical goods, food products, or even synthetic or processed energy sources." 447 U.S. at 453 n.6.

40. 460 U.S. 204 (1983).

41. *Id.* at 205 n.1.

firms and their employees.[42] The Court held that even though Boston did not transact directly with contractors' employees, the city effectively "employed" those working on construction projects because it ultimately paid for the projects.[43] The Court reasoned that the city, as the "buyer," maintained a proprietary interest in the end product of the projects and, thus, was a market-participant.[44]

The *White* decision suggests that state and municipalities can control the intermediary phases of production of products they have contracted to purchase.[45] As long as such state control has a legitimate relation to a state's proprietary interest—its right to receive an end product according to contract specifications—its activity is protected by the market-participant doctrine. Although the *White* Court recognized that there are limits to state control over parties affected by its transactions,[46] the Court did not articulate those limits until its deci-

42. *Id.* at 217 (Blackmun, J., dissenting).

43. The Court stated: "In this case, the mayor's executive order covers a discrete, identifiable class of economic activity in which the city is a major participant. Everyone affected by the order is, in a substantial if informal sense, 'working for the city.' " *Id.* at 211 n.7. By labeling Boston a "construction employer," the Court implied that it is not the form of the transaction but the substance of a state's involvement in the marketplace that determines whether the state may avail itself of the market-participant exemption. *Id.*

44. *Id.* at 209.

45. The dissent in *White* likened state control over parties outside the immediate transaction to downstream regulation. *Id.* at 220 (Blackmun, J., dissenting). *See supra* note 8 (discussion of downstream control). The dissent distinguished *Reeves* and *Alexandria Scrap* as cases in which the respective state dealt directly with the parties they affected. 460 U.S. at 218. On the other hand, "[a]ttempts directly to constrict private economic choices through contractural conditions are particularly akin to regulation because, unlike simple refusals to deal with like conventional market regulation, they threaten to extend their regulatory impact well beyond the transaction in which the state has an interest. *Id*, at 220 (Blackmun, J., dissenting).

In *White*, Boston did not attempt to regulate downstream by controlling production after it parted with title, risk of loss or dominion over the goods purchased. Rather, Boston sought to control production before it received its "goods, while still possessing a substantial interest in how the goods were produced. *Id.* at 208-11.

46. *Id.* at 211 n.7. The majority noted also that state activities shielded from commerce clause scrutiny by the market-participant exemption may still be challenged on other constitutional grounds. *Id.* at 211. *See also* United Bldg. and Constr. Trade Council v. Mayor of Camden, 104 S. Ct. 1020, 1027-30 (1984) (privileges and immunities clause may prohibit states from discriminating against nonresidents for state employment, despite fact that such discrimination is permitted under the market-participation doctrine); Hicklin v. Orbeck, 437 U.S. 518, 533-34 (1978) ("Alaska Hire" law discriminating against out-of-state residents on projects involving state-owned resources violative of the privileges and immunities clause); Pickering v. Board of Educ., 391 U.S. 563, 574-75 (1968) (state as employer cannot discharge teacher for exercising

sion in *South-Central Timber Development, Inc. v. Wunnicke*.[47]

In *South-Central*, the Court reaffirmed the general rule of *Alexandria Scrap, Reeves* and *White*,[48] but drew a boundary for state proprietary activity under the market-participant doctrine.[49] Alaska contended that it was a participant in the timber market[50] and therefore, could condition the sale of its timber upon primary manufacture.[51] The Court noted, however, that Alaska neither owned nor operated timber processing plants[52] and concluded that, although Alaska was a participant in the timber-selling market, it was not a participant in the timber-processing market.[53] Alaska's requirement that purchasers process its timber before export was an attempt to control the purchaser after the state had parted with title, risk of loss and dominion over the timber. The Court labeled such attempted control over timber purchases as downstream[54] regulation and, as such, outside the boundaries of the market-participant exception.[55]

The *South-Central* Court gave two reasons for disallowing downstream restraints. First, the state did not retain a proprietary interest in the timber after its sale to South-Central.[56] Second, downstream restraints are regulatory by nature; their use allows a seller-state to

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her right to free speech on issues of public importance); Handsome v. Rutgers Univ., 445 F. Supp. 1362, 1367 (D.N.J. 1978) (equal protection clause requires state-owned university to readmit student whose prior school loans were discharged in bankruptcy); Penthouse Int'l. Ltd. v. Putka, 436 F. Supp. 1220, 1227-30, (N.D. Ohio 1977) (first amendment protects right to sell Penthouse magazine at newsstand in municipally owned airport despite the proprietary nature of the airport).

47. 104 S. Ct. 2237 (1984).

48. *Id.* at 2243 (the dormant commerce clause places no limitation on a state's activities if the state is acting as a market participant rather than a market regulator).

49. *Id.* at 2246-47. ("[T]he state may not avail itself of the market-participant doctrine to immunize its downstream regulation of the timber-processing market in which it is not a participant.")

50. Brief for Respondent at 28, South-Central Timber Dev., Inc. v. Wunnicke, 104 S. Ct. 2237 (1984).

51. 104 S. Ct. at 2244. *See supra* note 9 and accompanying text.

52. *Id.* at 2245.

53. *Id.* at 2246.

54. *Id. See supra* note 8.

55. *South-Central*, 104 S. Ct. at 2246.

56. *Id.* Both the doctrine of restraints on alienation and the antitrust laws discourage the retention of control over goods after the immediate transaction has occurred. *Id.*

restrict how, or with whom, a purchaser may subsequently deal.[57]

The Court rejected Alaska's contention that it could contractually bind South-Central to an in-state primary manufacturing requirement.[58] The Court noted that the commerce clause applies to both regulatory and contractual activities of states.[59] The commerce clause invalidates activities that have a substantial regulatory effect on phases of a production process outside of the stage in which the state is participating.[60]

Instead of contract privity, the Court tied the boundary of permissible state action to the state's proprietary interest.[61] When a state's proprietary interest ends, so too does its immunity from the commerce clause.[62] In short, the Court maintained that a state could act freely within the market in which it was participating, but could not attempt direct control of participants beyond that market. The Court further cautioned that "markets" must be narrowly defined in order to preserve the integrity of the commerce clause.[63]

After defining the boundary for permissible state activity, the Court distinguished *South-Central* from *Alexandria Scrap, Reeves* and *White*.[64] The majority demonstrated that in each of the latter cases the state or municipality was a participant in each market it affected.[65] In *Alexandria Scrap*, Maryland purchased scrapped automobiles.[66] In

57. *Id.*

58. Alaska required purchasers of state-owned timber to agree that timber cut under contract will not be transported for primary manufacture outside the state. *Id.* at 2239 n.1.

59. *Id.* at 2245-46.

60. *Id.* at 2245.

61. The Court stated:

> The limit of the market-participant doctrine must be that it allows a State to impose burdens on commerce within the market in which it is a participant, but allows it to go no further. The State may not impose conditions, whether by statute, regulation, or contract, that have a substantial regulatory effect outside of that particular market.

104 S. Ct. at 2245-46.

62. *Id.*

63. *Id.* at 2246. The Court reasoned that "[u]nless the 'market' is relatively narrowly defined, the doctrine has the potential of swallowing up the rule that states may not impose substantial burdens on interstate commerce even if they act with the permissible state purpose of fostering local industry." *Id.*

64. *Id.* at 2243-46.

65. *Id.*

66. 426 U.S. 794, 801-03 (1976).

Reeves, North Dakota sold cement.[67] In *White*, the city acted as an employer.[68] The Court detailed the distinction between *White* and *South-Central*. In *White*, the City of Boston did not attempt to regulate downstream; rather, it sought to control the production process while it still possessed a substantial proprietary interest in the goods produced.[69] The city had not relinquished dominion and control over the end product. In contrast, *South-Central* presented a situation in which Alaska attempted to control the manner in which purchasers could dispose of timber after it was brought from the state. Alaska possessed no proprietary interest in the timber. Because Alaska's primary manufacture regulations attempted to control markets beyond the one in which it was participating, the Court subjected the state's regulations to strict commerce clause scrutiny.[70]

The dissent in *South-Central*[71] argued that the distinction between states as market participants and states as market regulators[72] was more apparent than real. The dissent could not find a distinction between *White*, in which Boston regulated employment, and *South-Central*, in which Alaska regulated timber.[73] Further, the dissent believed the market-participant doctrine to be an exercise in formalism,[74] arguing that Alaska could have regulated South-Central's activities by developing a subsidy program, as the State of Maryland did in *Alexandria Scrap*, or by restricting sales of timber to in-state residents, as North Dakota did in *Reeves*.[75]

Justice Rehnquist's dissent makes a significant point. If states are allowed to conduct their activities under the guise of the market-participant doctrine, they will be able to remove themselves from commerce clause scrutiny altogether. States desiring to regulate commerce

67. 447 U.S. 429, 433 (1980).

68. 460 U.S. 204, 205 (1983).

69. 104 S. Ct. 2237, 2246 (1984).

70. Because Alaska did not qualify for the market-participant exemption, the Court analyzed the case under traditional commerce clause scrutiny. Applying the balancing test of *Pike*, see *supra* note 4, the Court held that Alaska's absolute ban on the export of unprocessed timber fell almost within the rule of per se invalidity, 104 S. Ct. at 2247.

71. 104 S. Ct. at 2248 (Rehnquist, J., dissenting).

72. For the distinction between market-participant and market-regulator, see *supra* notes 2-3 and accompanying text.

73. 104 S. Ct. 2248-49.

74. *Id.* at 2248.

75. *Id.* at 2249. *But see supra* note 33 (explaining that timber and other natural resources may not come under the ambit of the market-participant doctrine).

in a particular market simply could become marginal participants in that market, expending little through subsidies and bounties, while redirecting the flow of interstate commerce.[76] The purposes that animate the commerce clause—free trade and the promotion of a national market place—would thereby be circumvented.[77]

The dissent in *South-Central* had no difficulty with the anomalous regulatory license granted to states under the market-participant doctrine, but the *Reeves* dissent did.[78] The dissent in *Reeves* asserted that the only way to safeguard the national marketplace from state domination was by subjecting all state activity affecting commerce to commerce clause scrutiny.[79] Given the present state of the market-participant doctrine, the *Reeves* dissent is correct.

The *South-Central* Court attempted to restrict the applicability of the market-participant exemption to markets in which the state action is an active and immediate participant.[80] It went only halfway. Although the Court forbade states from *directly*[81] influencing markets in which they were not participants, the Court made no attempt to limit states' efforts to *indirectly*[82] influence downstream markets. For example, in *Alexandria Scrap*, Maryland legitimately redirected the flow of scrapped autos through its participation in the scrapped auto market. Maryland, however, might also have indirectly affected other

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76. For example:

> [A] state, particularly in times of high unemployment, will be tempted to act in its purchasing capacity to pay a small bounty for goods produced in-state and thereby purposefully redirect interstate commerce away from ore efficient out-of-state producers to the "purchasing" state in order to increase employment in the state and to broaden its tax base . . . . This effect will result in damaging the economies of other states not having similar programs.

Note, *supra* note 2, at 924-25.

77. *But see supra* note 23.

78. Reeves v. Stake, 447 U.S. 447-54 (Powell, J., dissenting).

79. *Id.*

80. *See also* text accompanying notes 59-60. 104 S. Ct. at 2245-46.

81 The Court does not articulate its holding in terms of direct or indirect effects on commerce. Nevertheless, the *South-Central* Court revoked a regulation that directly attempted to control downstream markets. *See supra* notes 52-55 and accompanying text. The language of the opinion also refers only to direct burdens on commerce: "The State may not impose conditions, *whether by statute, regulation, or contract*, that have a regulatory effect outside of that particular market. 104 S. Ct. at 2245-46 (emphasis added).

82. A state indirectly affects commerce by rerouting the flow of goods during an intermediary phase of production so as to cause a change in the final production process.

markets. By causing a concentration of scrap metal to be located in Maryland, out-of-state purchasers of such scrap metal might have experienced a higher average purchasing cost for the metal. Concomitantly, the availability of a larger supply of scrap metal to in-state users might have allowed them to purchase it at a lower average cost.[83] The Court's acquiescence to indirect downstream control, implicit in the rules of *Alexandria Scrap*,[84] remains.

The *South Central* Court did, however, embrace dicta[85] in *Reeves* that suggested the market-paticipant doctrine may not apply when states seek to affect the interstate flow of natural resources[86] or when states participate in an international market.[87] Because the Court found Alaska's activities outside of the market participant doctrine,[88] however, it did not apply the *Reeves* dicta.

The *South-Central* Court attempted to limit the effect of state proprietary activity to the specific market in which the state participates. The *South-Central* rule falls short of accomplishing this. Under the rule, states not only can directly affect the market in which they participate, but can also indirectly affect commerce downstream. It is conceivable that, in some instances, the indirect effects of state action could be more repugnant to the maintenance of a national marketplace than direct actions. If a cure for the indirect effects of state action can be accomplished only by eliminating direct state market-participatory action, anomalous applications of the market-participant doctrine will result.[89]

The *South-Central* Court recognized the need to narrow the zone of

83. *See Alexandria Scrap*, 426 U.S. 794, 824-26 n.6 (Brennan, J., dissenting).

84. *Id.* at 806. *See supra* notes 20-23 and accompanying text.

85. 104 S. Ct. at 2237.

86. Reeves v. Stake, 447 U.S. 429, 443 (1980). *See also supra* note 33.

87. *Id.* at 438 n.9. *See also supra* note 34.

88. *See supra* notes 49-55 and accompanying text.

89. In Smith v. Dep't. of Agriculture, 630 F.2d 1081 (5th Cir. 1980), the circuit court reviewed a fact pattern identical to *Reeves*, but held the state's actions nonproprietary.

The state, in *Smith*, owned display facilites for produce sellers and contributed funds for running a state fair. *Id.* at 1082. The state assigned choice selling locations to resident produce sellers. *Id.* Nonresidents were assigned to inferior selling locations, and, as a result, sold much less than they could have in a choice location. *Id.* The state asserted that it was a participant to the display-renting market. *Id.* at 1084. The court rejected this contention and held the state to be regulating the produce-selling market. *Id.* at 1085. In reality, the state was indirectly regulating the produce-selling market, a result allowed under the rule of *Alexandria Scrap*.

permissible state activity under the market-participant doctrine and, therefore, prohibited direct downstream regulation. At present, however, states still have the power to regulate downstream indirectly. In order to preserve the efficacy of the commerce clause, the Court needs to further restrict states' abilities to affect remote markets under the market-participant doctrine.

Stephen R. Roberti