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Shell Oil Co. v. City of Santa Monica: The Sticky Business of Setting Oil Pipeline Franchise Fees under the Dormant Commerce Clause

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SHELL OIL CO. V. CITY OF SANTA MONICA: THE STICKY BUSINESS OF SETTING OIL PIPELINE FRANCHISE FEES UNDER THE DORMANT COMMERCE CLAUSE

I. INTRODUCTION

On December 1, 1981 a Long Beach pipeline exploded, injuring four people and destroying nine homes.[1] Neighborhood activists, fearing similar mishaps in their own cities, pressed for reforms of state and federal laws governing the use of underground pipelines.[2] It was at this time that a long term lease agreement between Shell Oil Company and the City of Santa Monica permitting the use of oil pipelines running beneath city streets, expired.[3] City officials refused to renew the agreement unless Shell paid a higher fee and complied with additional safety regulations.[4] Instead of meeting the city's demands, Shell brought suit seeking a declaration: (1) that the commerce clause of the federal Constitution limited the franchise fee payable to Santa Monica to an amount no greater than the value of actual services provided by the City and; (2) that any franchise terms regulating safety were preempted by federal law.[5] In *Shell Oil Co. v. City of Santa Monica*,[6] Federal District Court Judge Robert Kelleher ruled against Shell on the first issue, concluding that because the city was acting as a market participant in a private market, com-

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1. Rainey, *Refinery Cities Welcome Pipeline Fees Ruling*, L.A. Daily J., July 14, 1986, § 2, at 1, col. 5. Contrary to the sensationalism generated by news reports describing pipeline explosions, pipelines are actually the safest means of transportation in the United States: "Of the major transport modes—automobile, bus, truck, railroad, water and air, pipelines have the best record of safe operation." CAL. LEGISLATURE ASSEMBLY COMMITTEE ON ENVIRONMENTAL QUALITY, REPORT ON UNDERGROUND PIPELINES IN CALIFORNIA 84 Supplemental Testimony (c) (Oct. 18, 1972).

2. Rainey, *Refinery Cities Welcome Pipeline Fees Ruling*, L.A. Daily J., July 14, 1986, § 2, at 1, col. 5; *see generally Bradley Opposes Oil Pipeline, Says City's Position Will Kill the Project*, L.A. Times, July 11, 1987, Pt. I (Front Page), at 33, col. 1 (Mayor opposed planned crude oil pipeline); *Bradley Will Oppose Plan for Oil Pipeline*, L.A. Times, July 10, 1987, Pt. II (Metro Section), at 1, col. 1 (Mayor opposed planned $225 million crude oil pipeline that would run beneath 13 cities, including parts of Glendale, Burbank and Los Angeles); *Pockets of Methane Gas Identified in 6 Areas of Southland*, L.A. Times, Oct. 15, 1986, Pt. II (Metro Section), at 1, col. 5 (potentially explosive gas found beneath city buildings).

3. Shell Oil Co. v. City of Santa Monica, No. CV 82-2362, at 1 (C.D. Cal. June 13, 1986).

4. *Id.*

5. *Id.* at 2.

6. No. CV 82-2362 (C.D. Cal. June 13, 1986).

merce clause restrictions did not apply to the city's franchise fee.[7] Further, even if these restrictions did apply, the increased fee would be permissible under current law.[8]

This Note examines the possible limitations the dormant commerce clause imposes upon the city's franchise fee. Two major dormant commerce clause areas are discussed. First, the general history of the market participant doctrine is outlined, followed by a discussion of the doctrine's applicability to the facts in *Shell*. Second, the line of tax decisions dealing with the dormant commerce clause is set forth. Santa Monica's franchise fee is then analyzed in terms of the most recent of these tax cases. Finally, this Note concludes by suggesting a possible legislative solution to the oil pipeline franchise fee problem.

II. *SHELL OIL CO. V. CITY OF SANTA MONICA*

A. *Facts of the Case*

In 1941, Shell Oil Company signed a forty-year franchise agreement with the City of Santa Monica, which allowed Shell to install and operate an underground pipeline beneath city streets.[9] The pipeline was ten inches in diameter, 3.9 miles in length and part of an 82.2 mile network used by Shell to transport crude oil from Ventura County to its Wilmington refinery in Los Angeles County.[10] The franchise came up for renewal in 1981[11] at which time Santa Monica proposed two changes in the terms of the agreement: (1) an increase in the annual rent from $1000 per mile to $59,000 per mile;[12] and (2) incorporation of seven pages of detailed

7. *Id.* at 4-8.

8. *Id.* at 8-13.

9. Shell Oil Co. v. City of Santa Monica, No. CV 82-2362, at 1 (C.D. Cal. June 13, 1986).

10. *Id.*

11. *Id.* In late 1980 and early 1981, before expiration of the original franchise, Shell and the City of Santa Monica began negotiating a franchise renewal. The City rejected Shell's offer of annual rental of approximately $8500 as inadequate. The parties then agreed to suspend negotiations to wait for independent appraisals of the value of the franchise and safety studies. An interim operating agreement was executed which was still in effect when Appellee's Answering Brief was filed on January 14, 1987. Appellee's Answering Brief at 5, Shell Oil Co. v. City of Santa Monica, No. 86-6103, No. 86-6206 (9th Cir. 1987).

12. No. CV 82-2362 at 1-2. If every section of the 82.2 mile pipeline was charged at the $59,000 per mile rate, the fees for the entire pipeline would cost Shell $4,849,800. Possibly, pipelines in other areas could also be subject to vastly increased rental fees. The City of Torrance hiked its pipeline franchise fees two years ago and recently the Los Angeles City Council enacted the highest pipeline franchise fee in southern California. Torrance City Attorney Stanley Remelmeyer feels that "the Los Angeles action will likely result in increased franchise fees countywide in the future." *L.A. Council Doubles Fees on Oil Pipelines*, The Evening Outlook (Santa Monica, Cal.), July 16, 1987, at A3, col. 1.

safety standards regulating the pipeline.[13]

Shell filed suit in 1982, asserting that the commerce clause of the federal Constitution prohibited the rent increase and preempted Santa Monica's proposed safety terms.[14] Federal District Court Judge Robert Kelleher upheld the increase in the rental rate against challenge under both the commerce clause of the federal Constitution[15] and similar provisions in the California Constitution.[16] However, the court determined that Santa Monica could not impose additional safety terms because the provisions of the Federal Hazardous Liquid Pipeline Safety Act (FHLPSA) preempted any local safety regulations.[17] Judge Kelleher's decision in *Shell Oil Co. v. City of Santa Monica* is presently on appeal in the Ninth Circuit.[18]

B. Reasoning of the Court

1. Market participant doctrine: monopoly limitation

In *Shell Oil Co. v. City of Santa Monica*,[19] the federal district court held that the increased rental rate for the oil pipeline was exempt from all scrutiny under the dormant commerce clause because the City of Santa Monica was acting as a market participant in an essentially private market.[20] A state or its subdivision, however, does not come within the

13. No. CV 82-2362 at 1-2.

14. *Id.* at 2.

15. *Id.* at 13.

16. *Id.* at 18.

17. *Id.* at 21. Although this Note does not discuss at length the safety regulations preemption issue in *Shell*, a brief explanation of what preemption is in this context may be helpful. A federal preemption issue arises whenever a state law seemingly conflicts with a federal law. Courts use a three-step analysis to decide the preemption question:

1. Is the federal law constitutional? If not, the state law will prevail, unless it is also unconstitutional.
2. Do the federal and state laws conflict?
   A. Is there an *express* conflict?
   B. Is there an *implied* conflict?
3. If a conflict exists, the supremacy clause of art. VI, section 2 of the federal Constitution declares that the federal law overrides or preempts the state law. *See* L. TRIBE, AMERICAN CONSTITUTIONAL LAW §§ 6-23 to 6-27 (1978).

18. Shell Oil Co. v. City of Santa Monica, No. 86-6103, No. 86-6206 (9th Cir. 1987). Oral arguments took place in the spring of 1987.

19. No. CV 82-2362 (C.D. Cal. June 13, 1986).

20. Santa Monica argued that the market participant doctrine extended to cases, such as the one at issue here, involving real property. Appellee's Answering Brief *supra* note 11, at 15. *See* Shayne Bros. v. District of Columbia, 592 F. Supp. 1128 (D.D.C. 1984) (market participant doctrine applied to city-owned land fill); County Comm'rs v. Stevens, 299 Md. 203, 473 A.2d 12 (1984) (county-owned dump sites exempt from commerce clause); Marine Park Boats, Inc. v. Halberg, 598 Misc. 2d 938, 297 N.Y.S. 2d 236, 240, *aff'd*, 33 App. Div. 2d 932, 306

scope of the market participant exception, and is therefore subject to commerce clause analysis where it holds a "complete monopoly" over the relevant market.[21]

Judge Kelleher, distinguishing the facts in *Shell* from those in *Western Oil & Gas Association v. Cory*,[22] concluded that Santa Monica did not have a "complete monopoly" comparable to the one possessed by the state of California in *Cory*.[23] In *Cory*, the state of California controlled all of the California coastline stretching from Mexico to Oregon.[24] The extreme hardship an oil company faced trying to transport oil around this 1200 mile coastline[25] led the court in *Cory* to rule that California's ownership of its coastline constituted a monopoly.[26] In contrast, Santa Monica's land in *Shell* was not the only reasonable means of access to the desired destination. In fact, Shell conceded the existence of a number of alternative means of transporting oil to its Wilmington refinery.[27] Moreover, Santa Monica's land did not enjoy a strategic geographic signifi-

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N.Y.S. 2d 656 (1969) (court rejected commerce clause challenge to rental increase for city-owned wharves).

21. Western Oil & Gas Ass'n v. Cory, 726 F.2d 1340, 1343 (9th Cir. 1984), *aff'd*, 471 U.S. 81 (1985) (4-4 decision).

22. 726 F.2d 1340.

23. *Shell*, No. CV 82-2362, at 8.

24. 726 F.2d at 1341.

25. "California spans the Pacific seaboard between the 32nd and 42nd parallels, a distance of 1,200 miles including coastal indentations." A. ROLLE, J. GAINES, THE GOLDEN STATE: A HISTORY OF CALIFORNIA 1 (1979).

26. *Cory*, 726 F.2d at 1343.

27. *Shell*, No. CV 82-2362, at 5. In Transcontinental Gas Pipe line Corp. v. Milltown, 93 F. Supp. 287 (D.N.J. 1950), the court countered Milltown's argument that the pipeline could be built elsewhere by stating:

> It is clear therefore that defendant municipality's zoning ordinance promulgated under the police power of the state can be sustained only if it is reasonable and justifiable and does not create an undue burden on interstate commerce. . . .
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> . . . .
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> The defendant stands only upon the suggestion of its mayor that other routes are available, which is corroborated by another witness. . . . The only efficacy of this testimony rests in the statements that the pipe line could be otherwise routed. This is almost axiomatic for as one of the defendant's witnesses on cross examination admitted a pipeline can be laid practically anywhere, including the side of the Empire State Building if expense is of no consideration.
>
> On the other hand the plaintiff has shown logical, efficient and economical reasons for following the right-of-way of the Public Service Electric and Gas Company in this particular congested industrial portion of this state. By doing so it insures a minimum of inconvenience to, and destruction of property of, others.
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> . . . .
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> . . . [T]he mere claim by defendant that its ordinance requires plaintiff to locate its pipe line in an alternative route, suggested as available, does not fortify it with power to impede the plaintiff in the prosecution of its legal objective in the field of interstate commerce. Such an attempt to obstruct interstate commerce under guise of an assertion of exercise of the police power must fail.

Id. at 294-95.

cance tantamount to that of the California coastline and, therefore, the market participant doctrine shielded the city's actions from dormant commerce clause analysis.[28] Because Santa Monica fell within the market participant exception to dormant commerce clause scrutiny, it could set a franchise fee for Shell's oil pipeline free of commerce clause restrictions.[29]

2. Survival of Santa Monica's franchise fee under dormant commerce clause scrutiny

The *Shell* court further reasoned that even if Santa Monica had held a monopoly over the oil company's access to its Wilmington plant and was subject to commerce clause scrutiny, the new franchise fee would still be valid because it was " 'not graduated by the amount of business, nor . . . fixed for the privilege of doing business.' "[30] If a fee or tax measures use, the commerce clause requires that the fee be calculated by a formula which measures *actual use*.[31] But, according to Judge Kelleher, a levy such as Santa Monica's franchise fee, which was not designed to meter use, did not violate the commerce clause.[32]

In *Shell*, the court compared the flat franchise fee imposed by Santa Monica to the percentage fee in *Western Oil & Gas Association v. Cory*.[33] In *Cory*, the state of California, acting under California Administrative

28. *Shell*, No. CV 82-2362, at 5. It is interesting to note that the major oil companies themselves have been accused of possessing a "natural monopoly" over pipelines in California:

> The usual method of moving crude oil from the fields to shipping ports and refineries is large pipelines. Pipelines are expensive to build. An independent producer can rarely build pipelines to market his production, and an independent refiner can rarely build pipelines to many or all of his sources of supplies. This leaves both producers and refiners at the mercy of those who own the existing pipelines, usually the major integrated oil companies. Exchange agreements are frequently entered into in California, but the owner of the pipeline can bargain from an unfair bargaining position.

REPORT OF THE CAL. ATT'Y GEN. TASK FORCE ON ENERGY at 8-9 (May 1974); *see generally* L. COOKENBOO, CRUDE OIL PIPELINES AND COMPETITION IN THE OIL INDUSTRY (1955).

29. See *infra* notes 54-98 and accompanying text for a history of the Supreme Court's market participant cases.

30. *Shell*, No. CV 82-2362, at 8 (quoting Western Oil & Gas Ass'n v. Cory, 726 F.2d 1340, 1344 (9th Cir. 1984), *aff'd*, 471 U.S. 81 (1985) (4-4 decision)).

31. *Id.* at 9. Fees which compensate the government for the use of government services or facilities are termed "user fees." The primary question in "user fee" cases has not been whether the government deserves compensation, but rather what formula will be used to arrive at the proper level of compensation. Judge Kelleher's emphasis in *Shell* on charging only for actual use in a "user" fee situation reflects this judicial concern for an equitable calculation. *See* Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, 405 U.S. 707 (1972); Clark v. Paul Gray, Inc., 306 U.S. 583 (1939); Ingels v. Morf, 300 U.S. 290 (1937).

32. *Shell*, No. CV 82-2362, at 12-13.

33. *Id.* at 8-9. *See* Western Oil & Gas Ass'n v. Cory, 726 F.2d 1340, 1341-42 (9th Cir. 1984), *aff'd*, 471 U.S. 81 (1985) (4-4 decision).

Code section 2005,[34] set a rental charge comprised of two parts: (1) a minimum annual rent of eight percent of the appraised value of the leased land and; (2) an additional charge based on the volume of commodities passing over the leased land.[35] The second part of the levy, based on the volume of oil passing through the pipeline, was a classic user fee. Because this fee was calculated using a determinable value—volume—the court was able to ascertain whether the fee paid by the oil company was reasonably related to the extent to which it utilized city services.[36] Reasoning in this manner, the court struck down the volumetric rate after it was found to be disproportionate to the benefits conferred by the state.[37]

Conversely, the first part of the state's fee in *Cory*, based upon a percentage of the appraised value of the land over which oil was transported,[38] did not measure actual use of the pipelines, and so could not vary with the amount of oil delivered. Therefore, because the percentage fee's relationship to city-provided services could not be accurately gauged, the court could not strike down the fee based on disproportionality.[39] The court's decision reflected judicial policy supporting abstention in cases where the court does not have the competence nor the resources to determine the constitutionality of a fee which is related to services which cannot be measured with reasonable certainty.[40]

Although not clear from the text of the *Shell* opinion, Judge Kelleher also may have accepted Santa Monica's argument that the franchise fee was akin to a real estate lease fee. Santa Monica conceded that it could not properly tax the company for the transportation of oil without demonstrating some measurable relationship between the tax and the services provided.[41] Instead, Santa Monica argued that the franchise fee

34. *Cory*, 726 F.2d at 1341. *See* CAL. ADMIN. CODE tit. 2, § 2005 (19xx) *as amended by* CAL. ADMIN. CODE tit. 2, § 2003 (1981).

35. *Cory*, 726 F.2d at 1342.

36. The city service involved in *Shell* was use of city-controlled property through which to lay and operate a pipeline. Conceptually, a fixed franchise fee based upon the value of an easement through city-controlled property closely resembles the percentage fee in *Cory*. Arguably, the franchise fee in *Shell* should be upheld as was the percentage fee in *Cory*.

37. 726 F.2d at 1344.

38. *Id.* at 1341.

39. *Id.* at 1344.

40. *Shell*, No. CV 82-2362, at 11; *see also Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 627-28 (1981) (state-severance tax on coal upheld against commerce clause attack).

41. *Shell*, No. CV 82-2362, at 12. Had the flow of oil itself been the measure of the levy a classic "user fee" situation would have existed. This occurs when a taxed item of commerce merely passes through the jurisdiction of the taxing body. In a typical "user fee" situation, the goods being charged for are within the taxing entity's jurisdiction for only a short time and, therefore, to avoid undue burden on interstate commerce, the relationship between the tax and

was a leasehold fee for the physical occupation of space by the pipeline.[42] Santa Monica stated that the oil passing through the pipeline was not taxed at all.[43] If the oil itself was not taxed, any relationship between the amount of oil passing through the pipeline and Santa Monica's fee would be irrelevant for commerce clause tax analysis; this relationship could not subsequently provide the basis for striking down the franchise fee.

III. Market Participant Doctrine

A. Background

1. Development of the dormant commerce clause

The federal government's power to regulate interstate commerce is derived from article one, section eight of the United States Constitution which provides that "Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States."[44] This clause can be used in two ways. First, Congress may affirmatively exercise its commerce power[45] by passing laws which expressly govern as-

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the services provided must be closely scrutinized. *See* Massachusetts v. United States, 435 U.S. 444 (1978) (state airport flight fees); Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, 405 U.S. 707 (1972) (head tax on enplaning passengers); Clyde Mallory Lines v. Alabama, 296 U.S. 261 (1935) (state port vessel fees).

42. *Shell*, No. CV 82-2362, at 12-13; Appellee's Answering Brief, *supra* note 11, at 35. The argument that the City of Santa Monica's franchise fee is a lease for the *land* through which the oil pipeline runs, meshes perfectly with the argument that the city's franchise fee cannot be "fairly related" to the volume of oil flowing through the pipeline. *See supra* notes 38-40 and accompanying text. So long as the franchise fee is characterized as levied strictly for use of land itself, the volume of oil pumped through the pipeline is irrelevant. In addition, if the franchise fee is measured by the fair market value of the real estate through which the pipeline runs, the city can more easily justify its new fee.

43. *Shell*, No. CV 82-2362, at 12-13.

44. U.S. Const. art. I, § 8, cl. 2.

45. Under the federal Constitution, only Congress has the affirmative commerce clause power to make laws and compel private individuals to act. Consequently, courts seeking to enforce the restrictions of the dormant aspect of the commerce clause must tread a fine line. They can invalidate state actions which unduly interfere with interstate commerce, but they cannot compel state action beyond this point. If a certain level of burden upon interstate commerce were negative one (−1), a court could push it back to zero (0), but never to positive one (+1).

In its reply brief to the Ninth Circuit, Shell argued that the holdings in Haskell v. Cowham, 187 F. 403, 407 (8th Cir. 1911) and West v. Kansas Natural Gas Co., 221 U.S. 229, 260 (1911) stood for the proposition that the state must undertake affirmative action under the commerce clause to grant franchises. Appellee's Reply Brief at 5, Shell Oil Co. v. City of Santa Monica, No. 86-6103, No. 86-6206 (9th Cir. 1987). In *Haskell* and *West* the court did force the state to grant franchises allowing pipelines to enter into interstate commerce, but both cases are distinguishable from *Shell*. In the two older cases, the Oklahoma law acted to prevent pipelines from crossing Oklahoma highways into neighboring states along the entirety of each border. The facts of these two cases resemble those in Western Oil & Gas Ass'n v.

pects of interstate commerce.[46] If a federal statute or a comprehensive

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Cory, 726 F.2d 1340 (9th Cir. 1984), *aff'd*, 471 U.S. 81 (1985) (4-4 decision), where the state of California controlled virtually the entire California coastline. When a state has a monopoly over all the routes a pipeline may travel to enter or leave the state's borders, a court will be more likely to strike down the state law as burdensome to interstate commerce.

The rulings in *Haskell* and *West* can be viewed as a glass of water; being half-empty or half-full is the same. Thus, what appears to be court compulsion of affirmative state action to grant pipeline franchises, is merely the reverse side of invalidating a state law which overly burdens interstate commerce. The courts never have the power to make affirmative law under the commerce clause, they can only do what is necessary to enforce the dormant commerce clause. In reality, though, the difference between what Congress and the courts can do under the commerce clause is not always clear, especially in complex factual situations.

46. The power to regulate interstate commerce is one of the powers specifically granted to Congress by the Constitution in article I, § 8. This commerce power is used in conjunction with the necessary and proper clause of article I, § 8, clause 18, which "empowers Congress to 'make all laws which shall be necessary and proper for carrying into Execution' both the specific legislative powers granted to Congress by article I, § 8 itself, and 'all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.'" L. TRIBE, *supra* note 17, § 5-3, at 227; *see also* McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819).

Chief Justice Marshall, in a preliminary discussion to Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824), "indicated that, in his view, congressional power to regulate 'commercial intercourse' extended to all activity having any interstate impact—however indirect.... This power would be plenary: absolute within its sphere, subject only to the Constitution's affirmative prohibitions on the exercise of federal authority." L. TRIBE, *supra* note 17, § 5-4, at 232; *see also* Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).

Later, however, the Court began to limit congressional power to regulate commerce by substituting a more formal classification in place of Chief Justice Marshall's approach in *Gibbons*. This classification distinguished interstate commerce, which could be regulated by Congress, from local activities, which could not be regulated by Congress. This was so, even if the *products* of these local activities would later enter "interstate commerce." L. TRIBE, *supra* note 17, § 5-4, at 234. *See* United States v. E.C. Knight Co., 156 U.S. 1 (1895).

The Court steered back towards Chief Justice Marshall's view of Congress' commerce power as absolute when it rendered its decision in NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937). In *Jones*, the Court held that:

> Congress could regulate labor relations at any manufacturing plant operated by an integrated manufacturing and interstate sales concern because a work stoppage at any such plant 'would have a most serious effect upon interstate commerce.' Since 1937, in applying the factual test of *Jones & Laughlin* to hold a broad range of activities sufficiently related to interstate commerce to justify congressional action, the Supreme Court has exercised little independent judgement, choosing instead to defer to the expressed or implied findings of Congress to the effect that regulated activities have the requisite 'substantial economic effect.' Such 'findings' have been upheld whenever they could be said to rest upon some rational basis.

L. TRIBE, *supra* note 17, at 235-36; *see, e.g.*, Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964); United States v. Wrightwood Dairy Co., 315 U.S. 110 (1942).

Presently, Congress can regulate not only acts which, taken alone, would have substantial economic effect on interstate commerce, but also separate acts which, taken as an aggregate, may reasonably be deemed to have a significant impact. Congress has relied upon this "cumulative effect" theory as its justification for many types of legislation formerly considered beyond the scope of the commerce power. These include "civil rights legislation, certain criminal statutes, regulatory measures affecting the sale of foods and additives, and a registration law for drug producers." L. TRIBE, *supra* note 17, § 5-5, at 236-37.

scheme of federal regulation enacted under Congress' commerce power directly conflicts with state regulation, the federal law governs.[47]

The second way in which the commerce clause restricts state power is through judicial enforcement of the federal government's implied power to regulate interstate commerce. When deciding a dormant commerce clause challenge to a state law, a court considers whether the state law conflicts with the purposes behind the enactment of the commerce clause.[48] In a typical dormant commerce clause situation, a state regulation or tax is challenged as interfering with the free flow of interstate commerce. Even though Congress may not have passed a law expressly

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47. As long as Congress acts within an area specifically delegated to it by the Constitution, here the power to regulate commerce granted to Congress by the commerce clause coupled with the necessary and proper clause, the supremacy clause assures that any resulting federal legislation will preempt state law which expressly conflicts with the federal legislation. Such cases raise no controversial issues of federal versus state power. The source of federal power becomes relevant, however, when state power is "ousted not because of specific conflict with what Congress has *done* but because of negative implications thought to flow from what Congress *might* have done." L. TRIBE, *supra* note 17, § 6-23, at 376. The dormant commerce clause, which is an example of this implied federal power, serves as a breeding ground for litigation since it is often unclear when a state law is in conflict with an implied federal power. Falling between express congressional power and totally implied federal power is a:

> hybrid category within which states are deemed powerless to act because of a vacuum deliberately, even if not expressly, created by federal legislation. In such cases, *any* state or local action, however consistent in detail with relevant federal statutes, is held invalid—not because of a "dormant" federal power thought to be constitutionally exclusive but rather because the federal legislative scheme announces, or is best understood as implying, a congressional purpose to "occupy the field."

L. TRIBE, *supra* note 17, § 6-23, at 376-77; *see generally* Note, *Preemption as a Preferential Ground: A New Canon of Construction*, 12 STAN. L. REV. 208 (1959).

48. L. TRIBE, *supra* note 17, § 6-2, at 320-21. It should be noted that because the courts' power to decide cases dealing with state interference with interstate commerce is an implied rather than an express constitutional power, judgments in this area are always subject to congressional revision. *Id.* at 321. *See* Prudential Life Ins. Co. v. Benjamin, 328 U.S. 408 (1946).

> Four conceptual justifications support a dormant aspect to the commerce clause:
> (1) Diminution of power: The affirmative grant of the commerce power to Congress operates to diminish the reserved general regulatory and taxation powers of the state where the regulation or tax affects interstate commerce; (2) Implied intention of Congress: The failure of Congress to authorize specifically state regulation or taxation affecting interstate commerce in certain circumstances indicates that Congress intended that state regulation or taxation be precluded in those circumstances; (3) The free trade principle: A major historical purpose for the grant of the commerce power to Congress was to establish a national free trade area; state regulation or taxation that unreasonably burdens interstate commerce or interferes with interstate trade or movement is unconstitutional; (4) The nondiscrimination principle: A major historical purpose for the grant of the commerce power to Congress was to prevent economic protectionism and discrimination against interstate commerce or out-of-state interests in favor of local commerce or in-state interests; state regulation or taxation that discriminates against interstate commerce or out-of-state interests because of the interstate nature of that commerce or the out-of-state nature of those interests is unconstitutional.

Sedler, *The Negative Commerce Clause As A Restriction On State Regulation And Taxation:*

dealing with the subject area of the state regulation or tax, the dormant commerce clause may still preclude the state from enforcing a burdensome regulation or tax. Thus, the negative aspect of the commerce clause allows the federal government, through the courts, to control more areas than it could if only Congress' affirmative actions controlled.[49]

When a state regulation is challenged under the dormant commerce clause, the court will normally perform a test that attempts to weigh the competing state and federal interests. Traditionally, the Supreme Court has used a balancing approach which focuses on the *effect* rather than the *form* of a challenged state action.[50] Under the Court's present test, a "State regulation affecting interstate commerce will be upheld if (a) the regulation is rationally related to a legitimate state end, and (b) the regulatory burden imposed on interstate commerce, and any discrimination against it, are outweighed by the state interest in enforcing the regulation."[51]

If the state's regulation does impede interstate commerce, the state must show that it has a legitimate reason for doing so. Such a legitimate reason may not, however, be used as a guise for impermissible state ac-

An Analysis In Terms Of Constitutional Structure, 31 WAYNE L. REV., at 968-69 (footnotes omitted) (1985).

Professor Sedler argues that the nondiscrimination principle is the only sound structural basis for a dormant aspect to the commerce clause. *Id.* at 991-97.

49. Shell argued that the restrictions of the dormant commerce clause applied to the specific facts in *Shell*. In Haskell v. Cowham, 187 F. 403, 407 (8th Cir. 1911) and West v. Kansas Natural Gas Co., 221 U.S. 229, 260 (1911), the commerce clause "was used to strike down an Oklahoma statute prohibiting pipeline companies from crossing beneath state highways if they were transporting natural gas out of state and to compel the state to issue crossing rights." Appellant's Opening Brief at 7, Shell Oil Co. v. City of Santa Monica, No. 86-6103, No. 86-6206 (9th Cir. 1987). The court in Gulf Interstate Gas Co. v. Rapides Parish Police Jury, 115 F. Supp. 746 (W.D. La. 1953), ruled that a local ordinance which prevented pipelines from passing through was invalid on commerce clause grounds. In Kassell v. Consolidated Freight Ways, 450 U.S. 662 (1981), the commerce clause was used to strike down an Iowa statute which forced certain types of trucks to bypass the state, and in Transcontinental Gas Pipeline Corp. v. Milltown, 93 F. Supp. 287, 294-95 (D.N.J. 1950), "the court held that a city could not enact zoning restrictions which would prohibit an interstate pipeline from passing through." Appellant's Opening Brief, *supra*, at 8.

50. Note, *The Market Participant Test in Dormant Commerce Clause Analysis—Protecting Protectionism*, 1985 DUKE L.J. 697, 700-01 (1985). The Court has developed two distinct lines of cases in the commerce clause area—one for challenges to state taxes and one for challenges to state regulations. The line of cases dealing with challenges to state taxes is discussed *infra* at notes 168-233 and accompanying text.

51. L. TRIBE, *supra* note 17, § 6-5 (1978); *see, e.g.*, Cities Serv. Co. v. Peerless Oil & Gas Co., 340 U.S. 179, 186-87 (1950); Southern Pac. Co. v. Arizona, 325 U.S. 761, 770-71 (1945). Professor Christopher May, Bradley Chair in Constitutional Law, Loyola Law School, Los

tions.[52] For example, state law cannot be justified as necessary to protect public health when, in fact, the law is designed to protect economic interests within the state.[53]

2. Market participant doctrine

a. United States Supreme Court cases

In recent cases, the Supreme Court has held that a state's actions are exempt from dormant commerce clause scrutiny if the state is acting as a market participant[54] rather than as a market regulator.[55] The market participant doctrine stems from fundamental principles of state sovereignty. In the preeminent case in this area, *Reeves, Inc. v. Stake*,[56] the Court stated that "state proprietary activities may be, and often are, burdened with the same restrictions imposed on private market participants. Evenhandedness suggests that, when acting as proprietors, States should similarly share existing freedoms from federal constraints, including the inherent limits of the Commerce Clause."[57]

The doctrine was first used by the Supreme Court in *Hughes v. Alexandria Scrap Corp.*[58] Under Maryland law, scrap processors located

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Angeles, has synthesized the various methods that the Court uses to evaluate state regulations under the commerce clause into a workable outline:

Dormant Commerce Clause Analysis

1. Is there a *legitimate* state purpose for the law?
2. Is there a *rational* relationship between the law and this state purpose?
3. Do the benefits to the state clearly *outweigh* the burdens upon interstate commerce?

3a. Has the state used the *least burdensome* alternative? (This prong of the analysis has not been established to the same extent as the other parts of the test. Use of this requirement makes it very difficult for state laws to pass judicial scrutiny under the commerce clause).

4. Has the state used the *least discriminatory* alternative to accomplish its goal? (The state does not have to use the least discriminatory alternative if this alternative does not function as well as the present state regulation. Distinguish this from the more stringent prong 3a where a less burdensome alternative may be required even if it is less efficient).

5. Is there an *extraterritorial effect* of the law? (A state law which unduly affects commerce outside of that state may be per se invalid). Derived from class lectures in Constitutional Law given by Professor Christopher May, Loyola Law School of Los Angeles (Fall Semester 1986). See Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) for a summary of the Court's approach in the dormant commerce clause area.

52. *See* Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935) (New York statute limiting importation of out-of-state milk held unconstitutional as protectionist measure).

53. *Id.*

54. Market participant in this context refers to a situation where a state or a subdivision of a state enters into the private marketplace as a seller or a buyer of goods or services.

55. Market regulator in this context refers to a situation where a state or a subdivision of a state acting under its sovereign authority passes laws regulating the private market.

56. 447 U.S. 429 (1980).

57. *Id.* at 439.

58. 426 U.S. 794 (1976).

both within and outside Maryland received bounties from the state for recycling old automobiles.[59] In 1974, the Maryland legislature changed the law and required out-of-state processors to obtain a detailed documentation on an abandoned automobile before they could recycle it, whereas in-state processors only had to obtain a simple indemnity agreement.[60]

An out-of-state processor brought suit claiming that the 1974 law unduly burdened interstate commerce.[61] The district court agreed that the state law imposed "substantial burdens upon the free flow of interstate commerce."[62] Under a commerce clause balancing test performed by the district court, the decreased number of automobiles the out-of-state processor was able to handle (federal interest in the free flow of interstate commerce) outweighed legitimate state concern in reducing the amount of state funds paid for processing cars abandoned out of the state (state interest).[63]

In reversing the decision, the Supreme Court found that "Maryland has not sought to prohibit the flow of hulks, or to regulate the conditions under which it may occur. Instead, it has entered into the market itself to bid up the price."[64] Relying upon the principle of free enterprise behind the enactment of the commerce clause,[65] the Court held that "[n]othing in the purposes animating the Commerce Clause forbids a State, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others."[66] Another policy reason behind the Court's decision was the positive aspect of allowing individual states to create innovative programs to solve local problems.[67]

The *Alexandria Scrap* decision has been criticized. In his dissenting opinion, Justice Brennan expressed concern that Maryland's law affected too large an area of interstate commerce to allow Maryland to be exempt as a market participant from commerce clause scrutiny.[68] Despite an appearance of valid intent, the Maryland law would not have been allowed under a traditional commerce clause analysis because " 'a state

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59. *Id.* at 796-98.
60. *Id.* at 800-01.
61. *Id.* at 802.
62. *Id.* at 804.
63. *Id.*
64. *Id.* at 806.
65. See *supra* note 48 for an outline of the conceptual justifications supporting a dormant aspect to the commerce clause.
66. *Hughes*, 426 U.S. at 810 (footnote omitted).
67. *Id.* at 817 (Stevens, J., concurring).
68. *Id.* at 824 (Brennan, J., dissenting).

may not, in any form or under any guise, directly burden the prosecution of interstate business.' "[69]

Constitutional law scholar Laurence Tribe also found fault with the majority's opinion. According to Tribe, *Alexandria Scrap* cannot "be satisfactorily explained by any notion that, when a state acts as buyer or seller rather than regulator, its claim to autonomy as a state in the federal system suddenly overrides ordinary commerce-clause considerations."[70] Instead, Tribe reasoned that the Court should have upheld Maryland's selective bonus program because it "had not denied consumers in Maryland or elsewhere the opportunity to enjoy lower prices or higher quality in the way that state interferences with out-of-state suppliers or servicers ordinarily do; unlike most 'local grabs,' this one did not appear to injure consumers or secondary purchasers."[71]

In *Reeves, Inc. v. Stake*,[72] the Court again addressed the issue of the impact of the dormant commerce clause on state proprietary action. In *Reeves*, the state of South Dakota operated a plant which for many years supplied out-of-state buyers with cement.[73] During a span of twenty years, Reeves, Inc. (Reeves), a concrete distributor located in Wyoming, purchased 95% of its cement from this state operated plant. When a construction boom occurred which depleted the supply of cement, the state decided to favor all South Dakota customers over out-of-state buyers. The state informed Reeves that the state plant could no longer supply Reeves with cement.

Reeves then brought suit challenging the plant's preference for South Dakota buyers. The district court permanently enjoined the practice, reasoning that "South Dakota's 'hoarding' was inimical to the national free market envisioned by the Commerce Clause."[74] The Eighth Circuit reversed and held that the practice was permissible under the market participant doctrine.[75] The Supreme Court affirmed.[76]

In rebutting the argument that South Dakota had "exploited" the interstate market, the Court found that "neighboring States long have benefited from South Dakota's foresight and industry."[77] The Court re-

69. Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 522 (quoting Best & Co. v. Maxwell, 311 U.S. 454, 455-56 (1940)).

70. L. TRIBE, *supra* note 17, § 6-10, at 337.

71. *Id.*

72. 447 U.S. 429 (1980).

73. *Id.* at 430-32.

74. *Id.* at 433.

75. *Id.*

76. *Id.* at 447.

77. *Id.* at 440.

fused to invalidate the state's practice because to do so "would interfere significantly with a State's ability to structure relations exclusively with its own citizens."[78] Further, such a holding would inhibit local governments from trying new ways to solve local problems.[79]

The Court did not accept the assertion that South Dakota should not be allowed to ban the export of cement since previous cases had held that individual states could not hoard their commodities or resources.[80] Cement was different from the natural resources at issue in the other cases, the Court ruled, because cement is marketed in a manufactured rather than natural state.[81]

In his dissent, Justice Powell argued that the South Dakota policy represented the kind of economic protectionism that the Commerce Clause was designed to prevent.[82] Justice Powell asserted that a "[s]tate enter[ing] the private market and operat[ing] a commercial enterprise for the advantage of its private citizens, . . . may not evade the constitutional policy against economic Balkanization."[83]

One of the dangers of allowing a state to act free from the restraints of the commerce clause via the market participant doctrine is that parties removed from the initial transaction may be affected by the state's action. For example, in *White v. Massachusetts Council of Construction Employers, Inc.*,[84] the Court, in an opinion written by then Associate Justice Rehnquist, upheld an order by the mayor of Boston requiring that all construction projects funded by city funds be performed by a work force consisting of at least one half bona fide city residents.[85]

Justice Blackmun, joined by Justice White, dissented, arguing that limitations should be placed upon the state's ability to shield its actions

78. *Id.* at 441.

79. *Id.*

80. *Id.* at 443; *see, e.g.*, Baldwin v. Montana Fish & Game Comm'n of Montana, 436 U.S. 371, 385-86 (1978) (right to hunt elk not "fundamental" right protected by privileges and immunities clause). *Cf.* Hughes v. Oklahoma, 441 U.S. 322 (1979) (minnows); Philadelphia v. New Jersey, 437 U.S. 617 (1978) (landfill sites); Pennsylvania v. West Virginia, 262 U.S. 553 (1923) (natural gas); West v. Kansas Natural Gas Co., 221 U.S. 229 (1911) (natural gas); Note, *Solving New Jersey's Solid Waste Problem Constitutionally or Filling the Great Silences with Garbage*, 32 RUTGERS L. REV. 741 (1979).

81. 447 U.S. at 444.

82. *Id.* at 447 (Powell, J., dissenting). Justice Powell's dissent in *Reeves* is particularly interesting in light of the fact that he authored the majority opinion in *Alexandria Scrap*, where the market participant doctrine was first used. *See supra* notes 58-71 and accompanying text.

83. 447 U.S. at 449-50 (Powell, J., dissenting).

84. 460 U.S. 204 (1983).

85. *Id.* at 205-06.

from commerce clause scrutiny under the market participant doctrine.[86] Because the mayor's order directly restricted the ability of private employers to hire nonresidents, the order violated the premise of free trade upon which the market participant doctrine was based.[87] Justice Blackmun contended that the market participant doctrine was never meant to allow for regulation of third-party transactions under the guise of a right of a state to operate in the private sector.[88] Rather, he argued, a proper test of the legitimacy of a claim to the market participant doctrine depends upon "whether a particular state action more closely resembles an attempt to impede trade among private parties, or an attempt, analogous to the accustomed right of merchants in the private sector, to govern the State's own economic conduct and to determine the parties with whom it will deal."[89]

Following this line of reasoning, in *South-Central Timber Development, Inc. v. Wunnicke,*[90] the Court recognized that where a state attempts to regulate parties beyond those with whom it had originally contracted, the market participant doctrine will not apply.[91] In *South-Central Timber Development,* the Court struck down an Alaska law requiring that timber buyers partially process logs before exporting them outside of Alaska.[92] Justice White wrote for the majority:

> [t]he 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.[93]

Justice White added that an overly broad definition of the market participant doctrine had the potential to defeat the goal behind the commerce

86. *Id.* at 216-25 (Blackmun, J., dissenting).

87. *Id.* at 217-18 (Blackmun, J., dissenting).

88. *Id.* at 217-19 (Blackmun, J., dissenting).

89. *Id.* at 218 (Blackmun, J., dissenting). The Court may have retreated from its holding in *White* and moved closer to Justice Blackmun's dissent in that case when it decided United Bldg. & Constr. Trades Council v. Camden, 465 U.S. 208 (1984). In *Camden,* a municipal ordinance required that at least 40% of the employees of contractors and subcontractors working on city construction projects be city residents. The effect of this ordinance was identical to the statute in *White.* The Court, which had upheld the statute in *White* against commerce clause attack, stated that it might be possible to strike down the ordinance in *Camden* on privileges and immunities grounds.

90. 467 U.S. 82 (1984).

91. *Id.* at 97-99.

92. *Id.* at 100.

93. *Id.* at 97.

clause of eliminating obstructions to interstate commerce.[94]

The facts of *South-Central Timber Development* fall in the gray area between state regulations which affect the entire public and state self-imposed rules which deal only with the state's conduct as a purchaser, seller or employer in a particular market or industry. "In the former case, the state's rule affects every decision to purchase, sell, or hire in the relevant market; in the latter case, it affects only the transactions in which the state itself is involved."[95] The latter type of transaction arguably has little impact upon "the natural functioning of the interstate market."[96]

In conclusion, by recognizing the "downstream effects" limitation on the market participant exception, the Court acknowledged that state governmental action can never be totally analogous to that of a private trader. A private market participant's actions would never be suspect merely because of the fact that they reach outside of that particular market. Perhaps the Supreme Court refused to allow a state this same freedom due to the fact that a state's proprietary activities are at best only one step removed from its sovereign capacity.

The market participant doctrine provides blanket immunity from the restrictions of the dormant commerce clause with the consequent failure to balance state and federal interests. State activities which would be struck down under a balancing approach are permitted if the state is acting as a participant in the market.[97] Therefore, a state or a state subdivision may be able to shield otherwise unconstitutional regulations or taxes behind a guise of proprietary action.[98]

b. *Western Oil & Gas Association v. Cory*

Although the Supreme Court defined the market participant exception to judicial commerce clause analysis in only four cases, the doctrine continues to be invoked in lower court hearings.[99] In *Western Oil & Gas*

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94. *Id.* at 97-98.

95. Wells & Hellerstein, *The Governmental-Proprietary Distinction In Constitutional Law*, 66 VA. L. REV. 1073, 1127 (1980).

96. *Id.*

97. See Note, *supra* note 50, at 732-41 for an argument that the market participant doctrine should be more narrowly and objectively defined; see Comment, *Commerce Clause Immunity for State Proprietary Activities:* Reeves, Inc. v. Stake, 4 HARV. J.L. & PUB. POL'Y 365, 378-79 (1981) for an argument that the doctrine is invalid when governments take protectionist measures that distort the free market.

98. *See infra* notes 87-89 and accompanying text.

99. *See* Evergreen Waste Sys., Inc. v. Metropolitan Serv. Dist., 613 F. Supp. 127 (D. Or. 1986) (dormant commerce clause did not apply to local ordinance governing use of landfill because district was acting as market participant); Gary Concrete Prod., Inc. v. Riley, 285 S.C.

Association v. Cory,[100] the state of California claimed to be a market participant in its dealings with several oil companies.[101] The oil companies involved in *Cory* operated offshore drilling rigs and transported crude oil onshore by passing it over lands owned by the state of California.[102]

Due to the location of the drilling rigs and the fact that the state owned the tidal and submerged lands stretching for many miles in either direction, it was impossible for the oil companies to transport the oil without crossing state owned land.[103] When California increased the rental rates for use of this land, the oil companies filed a suit based on violations of the federal commerce clause.[104] The state defended its leasehold activities against the reach of the commerce clause on the grounds that it was "merely one of many participants in the market competing for leases."[105]

The Ninth Circuit held in *Cory* that because California had a complete monopoly over coastal access, it could not invoke the market participant doctrine.[106] In *Cory*, the state of California controlled the entire coastline and no reasonable alternatives were available.[107] Judge Tang wrote:

> Although some of the lands are in the possession of local State entities or private interests, this does not mean that California becomes one of many competitors. The permanency of plaintiff's facilities does not permit them to "shop around." There is no other competitor to which they can go for the rental of the required strip of California coastline. The Commission has a complete monopoly over the sites used by the oil companies. The companies have no choice but to renew their leases despite the volumetric rate, as the oil, gas and petroleum-derived products cannot be transported to plaintiff's facilities without trav-

498, 331 S.E.2d 335 (1985) (state statute giving preference to resident vendors held to be exercise of market participant doctrine); Gould, Inc. v. Wisconsin Dep't of Indus., Labor and Human Relations, 576 F. Supp. 1290, 1296 n.7 (W.D. Wis. 1983) (market participant doctrine did not shield state labor law from federal preemption).

100. 726 F.2d 1340.

101. *Id.* at 1342.

102. *Id.* at 1341.

103. *Id.*

104. *Id.* at 1342.

105. *Id.*

106. *Id.* at 1343. *But see* Brief of Amici Curiae for the Cities of Santa Monica, Culver City, Torrance and Huntington Beach, at 9, Cory v. Western Oil & Gas Ass'n, No. 84-16 (U.S. Oct. Term 1984).

107. 726 F.2d at 1343.

ersing the state-owned lands.[108]

In summary, a state possessing a monopoly cannot invoke the market participant doctrine in the same way that a private corporation holding a monopoly is limited by antitrust law. In both cases, the presence of a monopoly impedes the operation of a free market. Thus, if a state has a monopoly over a particular market it simply cannot be one of many participants in that market and will be subject to the restrictions of the commerce clause.

B. Analysis: Should the Market Participant Doctrine Allow Santa Monica's Franchise Fee to Escape Commerce Clause Scrutiny?

1. The parties' arguments

Judge Kelleher's decision to invoke the market participant doctrine to exempt the City of Santa Monica's actions from all dormant commerce clause analysis depended a great deal on how the city's actions were characterized. In support of its position that it was one of several market participants, Santa Monica discussed the relevance of real property and transportation, the significance of the alternatives available to Shell and the difference between a franchise renewal versus an original grant.[109] Shell's principal argument was that Santa Monica's possession of a monopoly precluded its use of the market participant doctrine.[110]

Santa Monica urged that the fact that real property was involved in the case did not call for any different analytical treatment concerning the application of the market participant doctrine.[111] Further, Santa Monica argued that the fact that Shell's activity was transportation, a field which sometimes receives great protection under the commerce clause, rather than another field such as manufacturing, was irrelevant.[112] According to Santa Monica, the only element of importance was "whether a partic-

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108. *Id.*

109. Appellee's Answering Brief, *supra* note 11, at 15-26.

110. Appellant's Opening Brief, *supra* note 49, at 16-17.

111. Appellee's Answering Brief, *supra* note 11, at 15. *See* Shayne Bros. v. District of Columbia, 592 F. Supp. 1128 (D.D.C. 1984) (market participant doctrine applied to city owned landfill); County Comm'rs v. Stevens, 299 Md. 203, 473 A.2d 12 (1984) (county owned dump sites exempt from commerce clause); Marine Park Boats, Inc. v. Halberg, 58 Misc. 2d 938, 297 N.Y.S.2d 236, 240, *aff'd*, 33 App. Div. 2d 32, 306 N.Y.S.2d 656 (1969) (rejected commerce clause challenge to rental increase for city-owned wharves).

112. Appellee's Answering Brief, *supra* note 11, at 15. *See* Salem Transp. Co. v. Port Auth., 611 F. Supp. 254 (S.D.N.Y. 1985) (permit charge based on percentage of gross transportation receipts not subject to commerce clause scrutiny); Transportation Limousine of Long Island, Inc. v. Port Auth., 571 F. Supp. 576, 581 (E.D.N.Y. 1983) (Port Authority compared to private participant in market for ground transport services).

ular state action more closely resemble[d] an attempt to impede trade among private parties, or an attempt, analogous to the accustomed right of merchants in the private sector, to govern the State's own economic conduct and to determine the parties with whom it will deal."[113]

Santa Monica readily admitted that surface use of streets and highways was protected by the commerce clause but argued that "the permanent and exclusive use of subsurface property falls into a different category altogether."[114] Santa Monica maintained that three reasons justified this distinction. First, while occasional surface use of streets involved a quintessential governmental activity, the street's underground use did not.[115] Second, the granting of easements should be treated as proprietary because of their exclusive and permanent nature.[116] The city's position was that "it is irrelevant whether the grantee obtains surface or subsurface rights. The transfer of property rights to franchisees, even in city streets, is a proprietary function of local government."[117] Third, the City of Santa Monica had an obligation to obtain proper compensation for land, here land beneath city streets, held in public trust.[118]

Santa Monica also countered Shell's argument that the city's possession of a monopoly precluded its use of the market participant doctrine

113. Appellee's Answering Brief, *supra* note 11, at 16 (quoting White v. Massachusetts Council of Constr. Employers, Inc., 460 U.S. 204, 218 (1983) (Blackmun, J., concurring in part)).

114. *Id. See, e.g.,* Kassel v. Consolidated Freightways Corp., 450 U.S. 662 (1981) (protectionist highway regulation burdens interstate commerce).

115. Appellee's Answering Brief, *supra* note 11, at 16. *See* Bibb v. Navajo Freight Lines, 359 U.S. 520, 523-24 (1959) (Illinois statute requiring trucks to use special mudguards held to unduly burden interstate commerce). Santa Monica added that "[s]treets are unique and indispensable when it comes to surface transportation. They are not, however, when it comes to a subsurface pipeline. The subsurface is no different wherever a pipeline is laid, whether it be under a street, other city property, or under private property." Appellee's Answering Brief, *supra* note 11, at 16-17.

116. Appellee's Answering Brief, *supra* note 11, at 17.

117. *Id. See* City of San Diego v. Southern Cal. Tel. Corp., 42 Cal. 2d 110, 266 P.2d 14 (1954); Sunset Tel. & Tel. Co. v. Pasadena, 161 Cal. 265, 118 P. 796 (1911); *see also* St. Louis v. Western Union Tel. Co., 148 U.S. 92, 98-105 (1892).

118. Appellee's Answering Brief, *supra* note 11, at 17-18; *see* Western Oil & Gas Ass'n v. California State Lands Comm'n, 105 Cal. App. 3d 554, 164 Cal. Rptr. 468 (1980); *see also* Los Angeles Athletic Club v. Board of Harbor Comm'rs, 130 Cal. App. 376, 386, 20 P.2d 130, 134 (1933) (lease to private parties not governmental function); Sunset Tel. & Tel. Co. v. Pasadena, 161 Cal. 265, 271, 118 P. 796, 798 (1911) (no right to occupy portions of public highways in absence of permission); Gurnsey v. Northern Cal. Power Co., 160 Cal. 699, 705, 117 P. 906, 908 (1911) (municipality may not give permission to enter highway if inconsistent with public easement); San Francisco St. Artists Guild v. Scott, 37 Cal. App. 3d 667, 670, 112 Cal. Rptr. 502, 504 (1974) (no right to conduct private business in public streets); Slemons v. Southern Cal. Edison Co., 252 Cal. App. 2d 1022, 1026, 60 Cal. Rptr. 785, 787 (1967) (private use must confer sufficient public benefit to be consistent with city's public use easement in streets).

by stating that "unlike the oil companies in [*Western Oil & Gas Association v.*] *Cory*, Shell has many viable alternatives from which to choose."[119] Santa Monica stressed that the importance of these alternatives to the market participant doctrine lay in the fact that "for Santa Monica to entice Shell to renew the franchise, the city cannot set its franchise fee so high that it would be more economical for Shell to go elsewhere."[120] Santa Monica pointed out that "even if Santa Monica possessed bargaining leverage," the city did not necessarily enjoy a monopoly.[121] Santa Monica conceded that it had a monopoly to the specific land through which the oil pipeline ran,[122] but warned that if such possession were legally held to be a monopoly, then all ownership of land could be construed to be a monopoly.[123]

Finally, Santa Monica disputed Shell's claim that the franchise renewal differed, for purposes of the market participant doctrine, from an initial grant.[124] Relying upon past cases dealing with the market participant doctrine, the city stated that it did not have the obligation to continue its present market activities simply because Shell had relied upon their existence.[125] To rule otherwise would force Santa Monica to renew the franchise ad infinitum.[126]

Shell, on the other hand, argued that the district court erroneously held that the market participant doctrine applied to this case.[127] Shell's primary contention was that the *Cory* monopoly exception to the market participant doctrine should be extended to the facts in *Shell Oil Co. v. City of Santa Monica*.[128] In *Cory*, the State of California controlled virtually all of the California coastline.[129] The *Cory* court held that because no viable transport alternatives available to the oil companies existed,

119. Appellee's Answering Brief, *supra* note 11, at 22. *See* Western Oil & Gas Ass'n v. Cory, 726 F.2d 1340 (9th Cir. 1984), *aff'd*, 471 U.S. 81 (1985) (4-4 decision); South Central Timber v. Wunnicke, 467 U.S. 82, 98 (1984); Shayne Bros. v. Prince George's County, 556 F. Supp. 182 (D.C. Md. 1983); Northern Pac. Ry. v. United States, 356 U.S. 1, 7 (1958); *see also* County Comm'rs v. Stevens, 299 Md. 203, 473 A.2d 12 (1984).

120. Appellee's Answering Brief, *supra* note 11, at 23.

121. *Id.* at 24.

122. *Id. See* Northern Pac. Ry. v. United States, 356 U.S. 1, 7 (1958); Shayne Bros. v. Prince George's County, 556 F. Supp. 182 (D.C. Md. 1983); *see also* County Comm'rs v. Stevens, 299 Md. 203, 473 A.2d 12 (1984).

123. Appellee's Answering Brief, *supra* note 11, at 24.

124. *Id.* at 25.

125. *Id.* at 25-26. *See Reeves*, 447 U.S. at 440; *Alexandria Scrap*, 426 U.S. at 809; Arrow Air, Inc. v. Port Auth. of New York, 602 F. Supp. 314, 321 (S.D.N.Y. 1985).

126. Appellee's Answering Brief, *supra* note 11, at 25-26.

127. Appellant's Opening Brief, *supra* note 49, at 13-19.

128. No. CV 82-2362 (C.D. Cal. June 13, 1986).

129. 726 F.2d at 1341, 1343; *see supra* note 25.

California possessed a "complete monopoly" and, therefore, could not invoke the market participant doctrine.[130]

Even if the possession of a complete monopoly by the defendant forecloses the application of the market participant doctrine, the problem of what constitutes a "complete monopoly" remains. Shell argued that "[t]he question of whether or not there is a monopoly is not a theoretical question, it is a practical question."[131] Shell analogized the City of Santa Monica's control of the pipeline located beneath city streets to the city's control over the surface of the streets for use by automobiles and pedestrians.[132] Just as the city could not "deny the reasonable use of the surface of those streets for vehicular and pedestrian traffic on the grounds that the traffic could always travel on private property or go through neighboring cities," it could not deny a similar right of way to underground pipelines.[133] In addition, Shell argued that the expense of relocating the existing refineries and pipeline "as a practical matter rule[d] out 'competing' means of transportation or alternate pipeline routes."[134] Thus, Shell contended, the City of Santa Monica enjoyed a complete monopoly over the corridor of land available for this particular pipeline and should be enjoined from invoking the market participant doctrine.[135]

Shell also urged that the conditions imposed on the franchise agreement by the City of Santa Monica did not further a major theory supporting the market participant exception: that competition is increased when the city or state is allowed to join the marketplace.[136] Shell argued that the advantages enjoyed by the city did not increase competition in a way that benefited anyone but the city itself.[137] From Shell's viewpoint,

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130. *Id.* Arguably, this same rationale applies on a smaller scale to the present case—the facts in *Shell* differ from those in *Cory* only in degree, not in kind.

131. Plaintiff's Memorandum of Points and Authorities Apr. 7, 1986 at 18, Shell Oil Co. v. City of Santa Monica, No. CV 82-2362 (C.D. Cal. June 13, 1986) [hereinafter Memorandum].

132. Appellant's Reply Brief at 11-15, Shell Oil Co. v. City of Santa Monica, No. 86-6103, No. 86-6206 (9th Cir. 1987).

133. Memorandum, *supra* note 131, at 18.

134. *Id.* at 18-19; see note 27 for an interesting twist to this complaint.

135. Appellant's Reply Brief, *supra* note 132, at 15-18.

136. Memorandum, *supra* note 131, at 11; *see also* Reeves, Inc. v. Stake, 447 U.S. 429 (1980); Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976).

137. Memorandum, *supra* note 131, at 11; *see* Wells & Hellerstein, *supra* note 95, at 1073 (1980). Michael Wells and Walter Hellerstein, law professors at the University of Georgia, wrote:

> [I]f economic Balkanization is the evil that the commerce clause was designed to prevent, what difference does it make whether the evil is brought about by states acting in their governmental or proprietary capacities? . . . To allow the state to Balkanize the national economy through its proprietary activities would be a triumph of form over substance—it would permit the states to do indirectly what they could not do directly and would fly in the face of the Court's express admonition.

the city was "attempting to benefit its citizens by charging an extraordinarily high and outlandish fee which Shell [would] then have to either absorb or pass on to consumers in general."[138] Shell asserted that "the City [was] attempting to hoard money, thereby benefiting its citizens at the expense of citizens elsewhere."[139] Because the city's rent increase did not benefit either commerce or consumers, the purpose behind the market participant doctrine was defeated.[140]

2. Failure of the sovereign/proprietary distinction

By deciding that the city, acting in its proprietary capacity, could raise its franchise fees, the *Shell* court was following Chief Justice Rehnquist's position that " 'the role of government as sovereign is subject to more stringent limitations than is its role of government as employer, property owner or educator.' "[141] Under this view "only sovereign inter-

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Id. at 1125.

138. Memorandum, *supra* note 131, at 11; *see also Reeves*, 447 U.S. at 429 (1980).

139. Memorandum, *supra* note 131, at 11.

140. However, it is worth noting "that the economically inefficient character of [a] state's action [does not] give rise to a commerce clause objection; economic efficiency, however desirable, is not a criterion of constitutionality under the commerce clause." Wells & Hellerstein, *supra* note 95, at 1126 (footnotes omitted).

141. Kreimer, *Allocational Sanctions: The Problem of Negative Rights in a Positive State*, 132 U. PA. L. REV. 1293, 1316 (1984) (quoting Board of Educ. v. Pico, 457 U.S. 853, 908-10 (1982) (Rehnquist, J., dissenting)). Chief Justice Rehnquist has been the foremost modern proponent of the sovereign/proprietary distinction. *See* Rehnquist, *The First Amendment: Freedom, Philosophy, and the Law*, 12 GONZ. L. REV. 1, 10-12 (1976) (suggesting separate categories for government as employer and as property owner); *see also* United States Postal Serv. v. Council of Greenburgh Civil Ass'ns, 453 U.S. 114, 129-30 (1981); Buckley v. Valeo, 424 U.S. 1, 290-91 (1976) (Rehnquist, J., concurring in part, dissenting in part) (discussion of sovereign/proprietary distinction); Southeastern Promotions, Ltd. v. Conrad, 420 U.S. 546, 571 (1975) (Rehnquist, J., dissenting) (lowered scrutiny of refusal to show the play "Hair" taken by city in its proprietary capacity); Memorial Hosp. v. Maricopa County, 415 U.S. 250, 283 (1974) (Rehnquist, J., dissenting) (refusal of medical care to indigent immigrants allowed); *see, e.g.*, Regan v. Taxation with Representation, 461 U.S. 540, 544-48 (1983) (taxing power subject to lesser constitutional restriction than criminal statutes).

Recently retired Justice Powell also endorsed the validity of the distinction. *See, e.g.*, Polk County v. Dodson, 454 U.S. 312, 318 (1981) (public defender's malpractice not attributable to any state action); Brown v. Glines, 444 U.S. 348, 356 n.13 (1980) (government acting as employer held to lower standard in free speech area); Greer v. Spock, 424 U.S. 828, 836 (1976) (state acting as private property owner has power to preserve property for its intended use); *cf.* Snepp v. United States, 444 U.S. 507, 509 n.13 (1980) (CIA may protect substantial government interests even by infringing some first amendment rights).

Many contemporary scholars, however, reject the distinction. *See* Linde, *Constitutional Rights in the Public Sector: Justice Douglas on Liberty in the Welfare State*, 40 WASH. L. REV. 10 (1965); Van Alstyne, *The Demise of the Right-Privilege Distinction*, 81 HARV. L. REV. 1439, 1458-64 (1968); *see also* Van Alstyne, *The Constitutional Rights of Public Employees*, 16 UCLA L. REV. 751, 754 n.14 (1969); *see, e.g.*, Zobel v. Williams, 457 U.S. 55 (1982) (conditions on interstate travel); Widmar v. Vincent, 454 U.S. 263 (1981) (conditions on use of state ference is forbidden interference"[142] and market participation by states performing proprietary functions is encouraged.

Several problems remain with the practical application of Chief Justice Rehnquist's theory. First, the actions of states taken in their proprietary capacities may infringe constitutional rights to the same extent as the actions of states made in their sovereign capacities.[143] For example, if the government, acting in a proprietary capacity, chose to revoke access to the United States mails by a dissident news magazine, first amendment rights would be harmed to a greater extent than if either a fine or a prison sentence had been imposed on the editor.[144] In addition, it is often easier for the government to deny allocation of a benefit rather than have to find and prosecute violators of a criminal statute.[145] Furthermore, a denial of benefits does not have to be drawn with the specificity or applied with the due process protections required in criminal prosecutions.[146]

A second problem with the Chief Justice's theory is that a government funded enterprise, even when it operates in a "free market," can

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university); Branti v. Finkel, 445 U.S 507 (1980) (conditions on government employment); McDaniel v. Paty, 435 U.S. 618 (1978) (conditions on public office); Lefkowitz v. Turley, 414 U.S. 70 (1973) (conditions on government contracts); Bond v. Floyd, 385 U.S. 116 (1966) (conditions on admission to legislature).

142. Kreimer, *supra* note 141, at 1316 (footnote omitted).

143. For example,

> [t]he Court has long recognized that fines may deter no less thoroughly than the threat of prison and taxes no less effectively than fines. From this recognition, it is only a short step to acknowledging that the deprivation of a monetary benefit by the government acting in its proprietary capacity may be an equally effective deterrent.

Kreimer, *supra* note 141, at 1318. *See* Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue, 460 U.S. 575, 585 (1983) (threat of burdensome and selective tax may effectively censor press); Grosjean v. American Press Co., 297 U.S. 233, 245-48 (1936) (holding newspaper revenue tax invalid and recounting historical instances of censorship through taxation of press); Lipke v. Lederer, 259 U.S. 557, 561-62 (1922) (tax on sale of liquor found to be penalty to enforce prohibition); Baily v. Drexel Furniture Co., 259 U.S. 20, 36-37 (1922) (tax on interstate trade in products of child labor found to be penalty for employment of children).

144. Kreimer, *supra* note 141, at 1318-19. *See* United States *ex rel.* Milwaukee Soc. Democratic Publishing Co. v. Burleson, 255 U.S. 407, 434-35 (1921) (Brandeis, J., dissenting) (revocation of second class mail privilege is "in effect a very heavy fine"); *cf.* Hannegan v. Esquire, Inc., 327 U.S. 146, 156 (1946) (denial of second class mail rate implicates constitutional rights).

145. Kreimer, *supra* note 141, at 1319. A denial of benefits is easy to implement. The government already knows who the people lining up to receive the benefit are—all the government must do is simply stop giving the aid. If the beneficiaries wish to continue receiving aid they may have to forego some rights. *See, e.g.*, Wyman v. James, 400 U.S. 309 (1971) (conditioning welfare payments on consent to home inspections). *Cf.* Zablocki v. Redhail, 434 U.S. 374, 387 & n.12 (1978) (parents of children from prior marriage must obtain court order certifying their ability to support those children not in their custody before remarrying).

146. Kreimer, *supra* note 141, at 1319.

never "claim the same genealogy as a private enterprise. Somewhere along the line it rests on the sovereign taxing power, and it cannot plausibly claim to be the unsullied product of freely adopted private choices."[147] Behind the so-called proprietary action of a public university or a state tax collector stands the armed might of the government. Neither "proprietor" would be able to assert its will so effectively if it did not have the sovereign and its monopoly on coercive violence supporting it.[148] Following this line of reasoning, state proprietary actions should be treated more nearly the same as state sovereign actions for purposes of determining their constitutionality.[149]

An opinion by Chief Justice Rehnquist demonstrates the failure of the sovereign/proprietary distinction.[150] In *United States Postal Service v. Council of Greenburgh Civic Associations*,[151] a federal statute made placing unstamped material in individual mailboxes in a government post office a crime.[152] The statute was challenged as an infringement of first amendment freedom of speech by a community organization that wanted to leave its newsletter in the mailboxes of its members.[153]

The Chief Justice upheld the statute by relying on the premise that the government as a private owner of property could preserve the property for its intended use.[154] However, what Chief Justice Rehnquist viewed as a wholly proprietary action by the government was actually

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147. *Id.* at 1320. However, Professor Kreimer also asserted that:

> In an ideal free market economy, more resources should accrue to those who more efficiently produce desirable goods and services. There is, therefore, a widely discussed efficiency justification for the ordering of economic power that results from private action. No such claim can be made for aggregations of capital formed through government's power to tax and appropriate funds.
>
> Moreover, the efficiency argument merely justifies the existence of some property rights, not of a particular distribution scheme that vests particular rights in the government. It provides more plausible support for the sovereign/proprietary distinction that has recently gained currency in commerce clause litigation.

Id. at n.84.

148. Kreimer, *supra* note 141, at 1320.

149. *See* Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985). In *Garcia*, the Court held that because distinguishing easily between "traditional" and "nontraditional" governmental functions was impossible, the rule in National League of Cities v. Usery, 426 U.S. 833 (1976), should be overturned. The Court in *National League of Cities* held that Congress, acting under its commerce power, could not pass legislation enforceable against the states "in areas of traditional governmental functions." 426 U.S. at 852. Because the Court ruled in *Garcia* that state sovereign and proprietary actions could not be distinguished for purposes of 10th amendment immunity, perhaps the sovereign/proprietary distinction upon which the market participant doctrine is based is no longer valid.

150. Kreimer, *supra* note 141, at 1321.

151. 453 U.S. 114 (1981).

152. *Id.* at 116.

153. *Id.* at 116-17.

154. *Id.* at 129-30.

sovereign. The government had not purchased the right to control access to the mailboxes, thereby taking the position of proprietor of those mailboxes. Instead, the government in its sovereign capacity, had made depositing unstamped material in the mailboxes a crime. Even if a state as a private property owner should be held to a lower standard of constitutional review than a state acting in its sovereign capacity, how will a court make a principled determination of this difference? Just as the Court has found identification of a private party's activities as state action increasingly difficult,[155] ascertaining when government is acting as a proprietor appears equally uncertain.

Extended to the facts in *Shell*, the court's inability to distinguish between sovereign and proprietary functions of government[156] leads to the conclusion that the market participant doctrine should not exist.[157] The question of whether the market participant doctrine exempted the activities of Santa Monica from the constraints of the commerce clause was overly dependent upon the characterization of these activities by the court. Because proprietary activities of government arguably should not receive even a lowered standard of constitutional review,[158] a strong argument can be made that total immunity for proprietary action is unwarranted. The claim by the city that it is only a market participant will always be tainted by the realization that the city's role as private property owner cannot be divorced from its role as tax assessor.[159]

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155. *See* Shelley v. Kraemer, 334 U.S. 1 (1948) (14th amendment held to bar state from enforcing restrictive racial covenant in private contract because of presence of state action denying petitioner's constitutional rights); *see also* Pennsylvania v. Board of City Trusts, 353 U.S. 230 (1957) (board of private college held to be agent of state and, therefore, subject to 14th amendment).

156. *See* New York v. United States, 326 U.S. 572, 583 (1946) (Court unanimously concluded that governmental/proprietary distinction was unworkable and must be abandoned); *see also* Massachusetts v. United States, 435 U.S. 444, 457 & n.14 (1978) (federal registration tax held not to violate implied immunity of state government from federal taxation); Case v. Bowles, 327 U.S. 92, 101 (1946) (Congressional Enabling Act held to govern state land sales designed to raise money for public schools).

157. This argument goes beyond those that Shell made. Shell conceded that the sovereign/proprietary distinction was possible when it stated that the market participant doctrine did not apply because "the City was acting in its governmental capacity, not in any proprietary capacity." Appellant's Opening Brief, *supra* note 49, at 15. *See* Mervynne v. Acker, 189 Cal. App. 2d 558, 561-62, 11 Cal. Rptr. 340, 343 (1961) ("Public highways belong to all the people of the state. Every citizen has the right to use them subject to legislative regulation.") Specifically, when the city decides who is to make what use of the public streets (to which the city only owns an easement) it is exercising a governmental power. Appellant's Opening Brief, *supra* note 49, at 15-16.

158. Kreimer, *supra* note 141, at 1322.

159. The argument can be made, however, that of all the subdivisions of the state, municipalities most deserve the protection afforded by the market participant doctrine. In recent years the courts have tended to treat local government units as

Further, the right to occupy streets for secondary purposes, such as pipes, poles and wires is frequently called a franchise.[160] A franchise is defined as a special privilege a city grants in its governmental capacity as opposed to a license which is a right or privilege a city bestows in a proprietary capacity.[161] Consequently, a municipality probably grants a privilege to lay an oil pipeline in its sovereign capacity. Therefore, a municipality's argument that it can escape the restraints of the dormant commerce clause by claiming that its action is proprietary is precluded.

This game of semantics is not one that a court should be forced to play. The ownership of the surface of streets has historically been held to be a sovereign activity,[162] although in some cases a private road system could conceivably serve as an alternative. Why, then, should the ownership of an easement to the subsurface of city streets be held not to constitute sovereign activity? A policy favoring access to a public road over access to subterranean land for an oil pipeline must rest on articulable grounds of decision. Granting that such a distinction may not exist, the denial of use of subsurface land for an oil pipeline should at least be subject to constitutional review.[163] The decision to exempt a municipal-

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> distinct from the sovereign state and the state's agents. For example, municipalities have not enjoyed Eleventh Amendment immunity; they are not exempt from enforcement of federal antitrust laws to the same extent as are the states themselves; and the Court has at least entertained the possibility that municipalities may have First Amendment rights.

L. TRIBE, *supra* note 17, at 7 (Supp. 1979) (footnotes omitted).

Thus, because municipalities are increasingly considered to be unlike the rest of the state and, presumably, closer to a private entity, perhaps they are also entitled to the benefits of the market participant doctrine. A market participant doctrine limited to cities and towns would still be a troublesome concept in light of the courts' difficulty with the sovereign/proprietary distinction, but at least this doctrine would be consistent with the courts' treatment of local government in other areas of constitutional adjudication.

160. 34 CAL. JUR. 3D *Franchises From Governmental Bodies* § 3, at 479 (1978); Stockton Gas & Elec. Co. v. San Joaquin County, 148 Cal. 313, 83 P. 54 (1905); Suisun City v. Pacific Gas & Elec. Co., 35 Cal. App. 380, 170 P. 1078 (1917).

161. 134 CAL. JUR. 3D *Franchises From Governmental Bodies* § 2, at 477 (1978); Copt-Air, Inc. v. San Diego, 15 Cal. App. 3d 984, 93 Cal. Rptr. 649 (1971).

162. *See* Kassel v. Consolidated Freightways Corp., 450 U.S. 662 (1981) (Iowa law banning trucks over fifty-five feet long struck down as unconstitutional burden on interstate commerce); Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959) (Illinois statute requiring contoured mudguards violated dormant commerce clause because most other states permitted straight mudguards); South Carolina State Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938) (use of state highways "peculiarly of local concern").

163. However, the market participant doctrine arguably should apply to the facts in *Shell* because enough of the burden of Santa Monica's action falls upon in-state residents (e.g., higher oil prices). This being the case, "the political process within the state should serve as an inner political check on the state's decisions to participate in the marketplace." J. NOWAK, R. ROTUNDA & J. YOUNG, CONSTITUTIONAL LAW § 8.9, at 284 (1986). See *infra* notes 231-33

ity's actions from commerce clause scrutiny must never rest on words alone.

IV. Dormant Commerce Clause Challenges to State Taxation

A. Background

Presuming that the market participant doctrine does not apply to the City of Santa Monica's actions, Santa Monica's franchise fee will be subject to judicial scrutiny under the dormant commerce clause. In *Shell Oil Co. v. City of Santa Monica*,[164] Judge Kelleher may have defined the franchise fee as a form of local tax.[165] To help explain Judge Kelleher's analysis of the city's franchise fee, this section presents a background on the dormant commerce clause tax cases. The first part of this background section discusses the line of cases leading to the development of the Supreme Court's present test of the validity of state taxes under the dormant commerce clause. In the second part of this section, the Supreme Court's present test as formulated in *Complete Auto Transit Inc. v. Brady*[166] is outlined. Finally, the third part discusses the United States Supreme Court's application of the *Complete Auto Transit* test to the facts in a case involving a state severance tax on coal: *Commonwealth Edison Co. v. Montana*.[167]

1. Shift in approaches prior to *Complete Auto Transit Inc. v. Brady*

Although in evaluating state taxation cases the Supreme Court could apply the interest-balancing approach used in evaluating state regulations under the dormant aspect of the commerce clause, it has not done so.[168] Two primary reasons explain the Court's reluctance: (1) the

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and accompanying text for a discussion of deference to the political process in the context of challenges to state taxation under the dormant commerce clause.

164. No. CV 82-2362 (C.D. Cal. June 13, 1986).

165. *Id.* at 8-13. The reader is cautioned that Santa Monica's franchise fee can be viewed as either a local tax or as a user fee. For a definition of the term user fee, see *supra* note 31. This Note takes the position that because the connection between the oil pipeline franchise fee and the value of the use of the city's easement beneath city streets is difficult to ascertain, the franchise fee is conceptually closer to a tax and a dormant commerce clause tax analysis should apply. However, if a measurable relationship between the franchise fee and the use of city-controlled property exists, a user fee situation would be present and a tax analysis would not apply. *See supra* notes 42-43 and accompanying text.

166. 430 U.S. 274 (1977).

167. 453 U.S. 609 (1981).

168. L. TRIBE, *supra* note 17, at 344; *see also id.* at 345 n.3. State taxes may infringe as much upon business conducting interstate commerce as do state regulations. "The power to tax is a dominant power over commerce." Freeman v. Hewit, 329 U.S. 249, 253 (1946).

state's ultimate interest remains the same in all tax cases—raising revenue;[169] and (2) an overlap exists between the tests used to determine the significance of the state's link with the taxpayer and those employed to measure the extent to which the state burdens interstate commerce.[170] Thus, state decisions concerning the validity of state taxes in relation to the demands of the commerce clause focus almost exclusively upon the taxes' adverse effect upon interstate commerce.[171]

From the time the Supreme Court handed down its first case invalidating a state tax as a violation of the dormant commerce clause,[172] it has vacillated in its approach to decision-making in this area. In the early cases, the constitutionality of a state tax depended upon whether it could be classified as a direct or indirect burden on interstate commerce.[173] A state tax on interstate commerce itself was a "direct burden" and beyond the reserved power of the state.[174] However, if a state tax affected a local

Although the Court has developed two distinct lines of commerce clause challenges, one for state regulations and one for state taxes, there has been overlap. For regulation cases that rely on tax cases: Philadelphia v. New Jersey, 437 U.S. 617 (1978); Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429 (1978); Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977); Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366 (1976); Pike v. Bruce Church, Inc., 397 U.S. 137 (1970). For tax cases that rely on regulation cases: Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977); Evansville Airport v. Delta Airlines, Inc., 405 U.S. 707 (1972); Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963); Nippert v. Richmond, 327 U.S. 416 (1946). Note, *Commerce Clause Restraints on State Taxation of Energy Resources: A Suggested Framework for Analysis*, 60 WASH. U.L.Q. 425, 431 n.25 (1982).

169. L. TRIBE, *supra* note 17, § 6-14, at 344.

170. *Id.*

171. *Id.*

172. Case of the State Freight Tax, 82 U.S. (15 Wall.) 232 (1872); *see generally* Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824); Cooley v. Board of Wardens, 53 U.S. (12 How.) 299 (1851). *Cooley* divided the possible subjects of regulation into two classes: (a) those *national in character* requiring exclusive control by Congress, and (b) those *local in character* allowing the states to have concurrent control along with Congress. This doctrine was first applied to the taxation area in *Case of the State Freight Tax*. For a general reference in this area, see P. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE (1953).

173. This approach to state taxation cases under the dormant commerce clause lasted roughly from the end of the Civil War to the eve of World War II. The artificial insulation from state taxation given to business under this approach was tolerated because of the high priority Americans gave to business growth and industrial expansion.

174. Under this direct/indirect approach, business which was *exclusively* interstate commerce could not be subjected to a franchise tax even if the tax was apportioned to activities within the taxing state. *See* Simet & Lynn, *Interstate Commerce Must Pay Its Way: The Demise of Spector*, 31 NAT'L TAX J. 53, 55 (1978). During this period the Court upheld taxes on the property of interstate businesses, including railroads, telegraph and telephone companies, that used their property exclusively in interstate transactions, on the premise that such taxes were only "indirect taxes" which did not impose an "undue burden" on commerce. Hellerstein, *State Taxation under the Commerce Clause: An Historical Perspective*, 29 VAND. L. REV. 335, 336 (1976).

activity,[175] placing only an "indirect burden" upon interstate commerce, the tax did not violate the tenets of the dormant commerce clause and, thus, was permissible.[176] Under this approach, a state could tax what was deemed a strictly local activity in order to avoid the restrictions of the commerce clause. This was true even if the state tax was measured by gross receipts or net income generated by interstate sales.[177]

On the other hand, state taxes levied solely on the privilege of doing business were struck down because they were classified as unconnected with local activity.[178] However, the Court's approach in this area was flawed by vagueness. The Court used the local versus non-local test to determine if a state tax was invoked for the privilege of doing business.[179] This test, which favored form over substance, proved unworkable since the Court encountered difficulty distinguishing local from non-local activity.[180]

In the late 1930's, the Court abolished the traditional notion that, under the dormant commerce clause, interstate commerce may not be taxed at all.[181] Prevailing economic theory at that time imposed a just share of state tax burdens upon interstate commerce.[182] What came to be known as the Multiple Burdens or Taxation Doctrine interpreted the commerce clause as forbidding discrimination against, or multiple taxation of, interstate commerce.[183] Generally, under this doctrine, a state tax imposed upon a business conducting interstate commerce had to be

175. State taxes on manufacturing, producing, mining and other businesses conducted within state borders were regarded as being imposed on activities taking place before the commerce began, i.e., "local" activities. Hellerstein, *supra* note 174, at 336.

176. Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897); Cleveland, Cincinnati, Chicago and St. Louis Ry. v. Backus, 154 U.S. 439 (1894).

177. *See* Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653 (1948); Joseph v. Carter & Weekes Stevedoring Co., 330 U.S. 422 (1947), *overruled*, Department of Rev. v. Association of Wash. Stevedoring Cos., 435 U.S. 734 (1978); Freeman v. Hewit, 329 U.S. 249 (1946); Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434 (1939); J.D. Adams Mfg. v. Storen, 304 U.S. 307 (1938); Fisher's Blend Station, Inc. v. State Tax Comm'n, 297 U.S. 650 (1936).

178. *See* Note, *Judicial Review Under* Complete Auto Transit: *When is a State Tax on Energy-Producing Resources "Fairly Related"?*, 1982 DUKE L.J. 682, 685 (1982); *see, e.g.*, Memphis Steam Laundry Cleaner v. Stone, 342 U.S. 389 (1952); Spector Motor Serv. v. O'Connor, 340 U.S. 602 (1951); Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203 (1925).

179. *See* Note, *supra* note 178, at 685.

180. Postal Telephone-Cable Co. v. City of Richmond, 249 U.S. 252 (1919); *see* Lockhart, *A Revolution in State Taxation of Commerce?*, 65 MINN. L. REV. 1025, 1030 (1981).

181. *See generally* Case of the State Freight Tax, 82 U.S. (15 Wall.) 232 (1873) (state freight tax imposed on interstate carrier held unconstitutional).

182. Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938) (Supreme Court upheld unapportioned gross receipts tax on *privilege* of selling advertising from magazine circulated interstate). *See* McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940).

183. *Western Live Stock*, 303 U.S. at 254-56.

carefully tailored to the amount of taxable activity occurring within the state. States which did not strictly apportion their taxes in this manner overtaxed. If several states enacted similar, excessive taxes, interstate businesses were taxed more than once for a single transaction leading to a cumulative burden upon interstate commerce not borne by local commerce.[184]

Such multiple taxation was not per se unconstitutional. A state could impose a tax upon a company conducting a strictly interstate business if that tax was properly apportioned and did not duplicate a tax already levied by another state.[185] However, apportionment was necessary only to avoid over- or undertaxation of an interstate transaction which could not be separated into a sufficiently local activity. If an interstate transaction could be related to a sufficiently local activity, it would, by that very fact, be "uniquely defined, and thus not capable of multiple application."[186] Additionally, a showing that such cumulative taxation was theoretically possible was insufficient; the challenger of the tax also had to convince the court that the "*particular* interstate transactions taxed [were] actually cumulatively burdened by multiple taxation . . . ."[187]

The Court's inconsistent approach to state taxation cases became apparent when the Court abruptly rejected the Multiple Burdens Doctrine in *Freeman v. Hewit.*[188] In *Freeman,* the state had imposed an unapportioned tax on the gross receipts of securities sold in New York by an Indiana trustee on behalf of an Indiana estate.[189] Justice Frankfurter, in striking down the state tax, argued that the commerce clause pre-

184. L. TRIBE, *supra* note 14, § 6-17, at 360.

185. Under this view, a state was not barred by the commerce clause from levying a fairly apportioned net income tax on a foreign corporation that conducted exclusively interstate business in the state. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959).

Also, a state could require out-of-state vendors, operating in the state only through independent contractors or brokers, to collect use taxes on shipments of goods to local customers. Scripto, Inc. v. Carson, 362 U.S. 207 (1960).

186. L. TRIBE, *supra* note 17, § 6-18, at 362. *See Western Live Stock*, 303 U.S. at 260; *Carter & Weekes*, 330 U.S. at 429.

187. L. TRIBE, *supra* note 17, § 6-17, at 360. *See* General Motors Corp. v. Washington, 377 U.S. 436 (1964); Central R.R. Co. v. Pennsylvania, 370 U.S. 607 (1962).

188. 329 U.S. 249 (1946). The *Freeman* Court refused to follow its prior ruling in Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938). In *Adams*, concerning roughly the same set of facts as *Freeman*, the Court held that an Indiana tax was invalid "when applied, *without apportionment*, to gross receipts derived from interstate sales of goods made by Indiana manufacturers who sold and shipped them to purchasers in other states." *Freeman*, 329 U.S. at 259 (Rutledge, J., dissenting).

189. 329 U.S. at 250-51.

cluded the states from impeding the free flow of trade between the states and that a direct tax on interstate commerce constituted such an impermissible burden.[190] He added that courts were not capable of properly weighing the various factors involved in determining the nonduplication of direct taxes.[191] Rather, it was the courts' task merely to draw lines: one example, the direct/indirect test.[192]

The weakness in the Court's approach of merely labeling what was an unconstitutional levy by a state was demonstrated by two cases decided after *Freeman*. In *Railway Express Agency, Inc. v. Virginia (Railway I)*,[193] a state tax was declared invalid because it was called a privilege tax.[194] In a second case involving the same parties, *Railway Express Agency, Inc. v. Virginia (Railway II)*,[195] the Court allowed the tax to stand after the Virginia legislature redrafted the statute to omit the word "privilege."[196] Thus, even though the effect of the tax remained the same, the use of another name made the tax valid under the ruling in *Freeman*.[197]

The resurrection in *Freeman* of the direct/indirect test was expanded upon in *Spector Motor Service, Inc. v. O'Connor*.[198] In *Spector*, Connecticut had levied a tax on the privilege of doing business which was measured by net income allocated to the state.[199] The taxpayer, an out-of-state corporation, operated an interstate trucking business with stops in Connecticut.[200] The Court invalidated the state tax, determining that the states could not levy even a fairly apportioned net income tax on the

190. *Id.* at 256-57. However, in an earlier part of the opinion, Justice Frankfurter did not shield all commercial activity from state taxation. He resurrected the "direct burden/indirect burden" distinction of the early cases by stating: "when accommodation must be made between state and national interests, manufacture within a State, though destined for shipment outside, is not a seamless web so as to prevent a State from giving the manufacturing part detached relevance for purposes of local taxation." *Id.* at 255.

191. *Id.* at 256.

192. *Id.* at 253-54; *see also* 44 P. KURLAND & G. CASPER, LANDMARK BRIEFS AND ARGUMENTS OF THE SUPREME COURT OF THE UNITED STATES: CONSTITUTIONAL LAW 437-684 (1975) (reprint of briefs and other court documents from *Freeman*).

193. 347 U.S. 359 (1954).

194. *Id.* at 369.

195. 358 U.S. 434 (1959).

196. *Id.* at 436.

197. *See* Colonial Pipeline Co. v. Traigle, 421 U.S. 100 (1975) (artificial distinction between "*privilege* of carrying on or doing business" and "*qualification* to carry on or do business"); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) (distinction drawn between invalid tax on privilege of engaging in interstate commerce and valid tax on net income derived from interstate commerce).

198. 340 U.S. 602 (1951).

199. *Id.* at 603.

200. *Id.* at 606-07.

privilege of doing an exclusively interstate business.[201]

In summary, during the *Freeman/Spector* era, a state could not tax business for the privilege of conducting interstate commerce within the state's borders. However, the weakness of this approach was its reliance on the label, rather than an inquiry into the actual effects of the tax. Consequently, a state could avoid the restrictions of the *Freeman/Spector* rule by simply calling its tax something other than a privilege tax.

2. The *Complete Auto Transit, Inc. v. Brady*[202] test

To avoid the problems associated with the "magic label" approach of the *Freeman/Spector* line of cases, the Court expressly reversed *Spector* in *Complete Auto Transit, Inc. v. Brady.*[203] In *Complete Auto Transit,* the plaintiff was a Michigan-based motor carrier that transported automobiles manufactured outside of Mississippi to Mississippi dealers.[204] The vehicles were first shipped by rail to Jackson, Mississippi, where, within forty-eight hours, they were loaded onto trucks destined for individual dealers.[205] A tax equal to five percent of the gross income of the plaintiff's business conducted within the state was levied pursuant to two Mississippi statutes.[206] The Mississippi Supreme Court, ruling that the state tax was constitutional, concluded:

> It will be noted that Taxpayer has a large operation in this State. It is dependent upon the State for police protection and other State services the same as other citizens. It should pay its fair share of taxes so long, but only so long, as the tax does not

201. *Id.* at 608-10.
202. 430 U.S. 274 (1977).
203. *Id.* at 288-89.
204. *Id.* at 276.
205. *Id.*
206. The Mississippi statutes authorizing this tax stated:

> There is hereby levied and assessed and shall be collected, privilege taxes for the privilege of engaging or continuing in business or doing business within this state to be determined by the application of rates *against gross proceeds* of sales or gross income or values, as the case may be, as provided in the following sections.

Miss. Code Ann. § 10105 (1942) (emphasis added), *amended by* Miss. Code Ann. § 27-65-13 (Supp. 1972).

> Upon every person operating a pipeline, railroad, airplane, bus, truck, or any other transportation business for the transportation of persons or property for compensation or hire *between points within this State,* there is hereby levied, assessed, and shall be collected, a *tax equal to five per cent of the gross income of such business.*

Miss. Code Ann. § 10109(2) (1942) (emphasis added), *amended by* Miss. Code Ann. § 27-65-19(2) (Supp. 1972).

Although the statutes could be interpreted as reaching both intrastate and interstate commerce, the state showed proof that the tax had been applied only to commercial transactions occurring within the state. *Complete Auto Transit,* 430 U.S. at 275 n.2.

> discriminate against interstate commerce, and there is no danger of interstate commerce being smothered by cumulative taxes of several states. There is no possibility of any other state duplicating the tax involved in this case.[207]

The plaintiff, relying on previous decisions holding that a privilege tax may not be applied to an activity that is part of interstate commerce, attacked the validity of the state's tax.[208] The United States Supreme Court, affirming the Mississippi Supreme Court's ruling, criticized these decisions because they did not consider the actual effect of the tax.[209] The Court stated that "[t]he rule reflects an underlying philosophy that interstate commerce should enjoy a sort of 'free trade' immunity from state taxation."[210] Instead, the Court insisted that interstate commerce must pay its just share of state tax burden. The Court further concluded that the focus should not be on the formal language of the tax statute but, rather, on its practical effect.[211] In upholding Mississippi's tax, the Court formulated a new test for judging the validity of state taxes under the dormant commerce clause. The Court ruled that a tax levied on the gross sales or receipts of a firm for the privilege of doing business within the state is constitutional if the tax: (1) is based upon a sufficient nexus between the state and the activities being taxed; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the state.[212]

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207. Complete Auto Transit v. Brady, 330 So. 2d 268, 272 (1976) *aff'd*, 430 U.S. 274 (1977).

208. 430 U.S. at 278; *see, e.g., Spector Motor Service*, 340 U.S. 602 (1951); *Freeman*, 329 U.S. 249 (1946).

209. 430 U.S. at 285.

210. *Id.* at 278 (footnote omitted). *See Freeman*, 329 U.S. at 252. The Court, in formulating the *Complete Auto Transit* test of state taxes attempted to fulfill what the Court in *Western Livestock* tried to do nearly 40 years before—ensure that businesses conducting interstate operations pay their fair share of the state tax burden. Arguably, the *Complete Auto Transit* test, presently in effect, shares a flaw inherent in the multiple burdens approach of *Western Live Stock*. Both tests may lead to overtaxation of interstate commerce since it is difficult to fairly apportion state taxes upon interstate enterprises.

211. *Complete Auto Transit*, 430 U.S. at 279 (citing Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)); *see, e.g.*, General Motors Corp. v. Washington, 377 U.S. 436 (1964); Northwestern Cement Co. v. Minnesota, 358 U.S. 450 (1959); Memphis Gas Co. v. Stone, 335 U.S. 80 (1948); Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940).

212. *Complete Auto Transit*, 430 U.S. at 279; *see* Simet & Lynn, *supra* note 174. The nexus requirement of prong one stems from both the due process clause and the commerce clause. In light of the *Commonwealth Edison* decision and the lower court cases following it, it can be argued that no fourth prong remains in the *Complete Auto Transit* test. *See infra* notes 216-33 and accompanying text. Although the Court articulated the "fairly related" requirement in *Complete Auto Transit*, it has not actually applied it in subsequent cases such as *Commonwealth Edison*. Because, under *Commonwealth Edison*, presence within the taxing entity's ju-

Arguably, elements one, two and four of the *Complete Auto Transit* test involve strictly due process concerns of reasonableness and fairness.[213] If these three requirements primarily concern due process, then only prong three of the *Complete Auto Transit* test reflects the intent behind the dormant commerce clause.[214] Under this interpretation of the test, a non-discriminatory state tax will always pass commerce clause scrutiny.[215]

3. Application of the *Complete Auto Transit* test in *Commonwealth Edison Co. v. Montana*

The *Complete Auto Transit* test was applied by the Supreme Court in *Commonwealth Edison Co. v. Montana*,[216] a case where the state of Montana imposed a severance tax on coal mined in the state.[217] In *Commonwealth Edison,* the tax was calculated "at varying rates depending on the value, energy content, and method of extraction of the coal," but did

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risdiction appears to be the only prerequisite to satisfying the fourth prong, the fourth prong may be merely an extension of the nexus requirement of prong one.

213. Sedler, *The Negative Commerce Clause as a Restriction on State Regulation and Taxation: An Analysis in Terms of Constitutional Structure*, 31 WAYNE L. REV. 885, 912 (1985). In a footnote, Professor Sedler quoted Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980):

> The Due Process Clause of the Fourteenth Amendment imposes two requirements for such state taxation [of the income of a business operating in interstate commerce]: a "minimal connection" or "nexus" between the interstate activities and the taxing State, and a "rational relationship between the income attributed to the State and the intrastate values of the enterprise." The tax cannot be out of all appropriate proportion to the business transacted by the [enterprise] in that State.

Id. at 219 (citations omitted). Sedler, *supra*, at 913 n.117.

The difference between the dormant commerce clause and the due process clause was commented on by Professors Nowak, Rotunda and Young:

> The "substantial nexus" portion of the modern commerce clause test is similar to the due process requirement except that the commerce clause test focuses on the burden [o]n interstate commerce: while the commerce clause will require that the state or local tax be fairly apportioned in order to prevent an undue burden on interstate commerce, the due process clause requires state jurisdiction to tax.

J. NOWAK, R. ROTUNDA & J. YOUNG, CONSTITUTIONAL LAW § 8.11, at 289 (1986).

Professor Sedler suggests that Western Oil & Gas Ass'n v. Cory, 726 F.2d 1340 (9th Cir. 1984), *aff'd*, 471 U.S. 81 (1985) (4-4 decision), should more properly have been decided on due process rather than negative commerce clause grounds. Sedler, *supra*, at 913 n.117.

214. Sedler, *supra* note 213, at 913.

215. In the decisions following *Complete Auto Transit*, a non-discriminatory state taxation of interstate commerce has always been upheld. *Id.* at 915.

In a footnote, Professor Sedler discussed the Court's different treatment of state taxation schemes affecting *foreign* commerce. He proposed that Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979), where the Court invalidated a California tax on Japanese cargo on dormant commerce clause grounds, should have been based, instead, on a federal foreign policy rationale. Sedler, *supra* note 213, at 915-16 n.130.

216. 453 U.S. 609 (1981).

217. *Id.* at 612-13.

not fluctuate according to the *amount* of coal extracted.[218]

In 1978, four Montana coal producers filed suit in Montana state court seeking a declaration that the tax was invalid under the supremacy and commerce clauses of the federal Constitution. Reviewing a decision from the Montana Supreme Court that found the tax unconstitutional, the United States Supreme Court ruled that the focus in deciding a commerce clause challenge to a state severance tax should be on the tax's practical effect rather than on whether the state tax is levied on goods prior to their entry into interstate commerce.[219] The Court noted that a state has a right to fair payment for state-provided services.[220]

Consequently, Justice Marshall, writing for the *Commonwealth Edison* majority, held that the Montana tax must be properly evaluated under the four-part test outlined in *Complete Auto Transit, Inc. v. Brady*.[221] The Montana tax clearly satisfied the first two prongs of the test. The coal companies, however, asserted that the tax violated the last two requirements.[222] The third prong was violated, the coal companies argued because the Montana tax discriminated against businesses engaged in interstate commerce; 80% of Montana coal was shipped out-of-state.[223] The Court disposed of this argument by stating that "the Montana tax [was] computed at the same rate regardless of the final destination of the coal. . . ."[224] The fourth part of the test was violated, the coal companies asserted, because the tax was not fairly related to any services provided by the state.[225] However, under the Court's reasoning, the mere *presence* of a taxed entity within the state was sufficient to satisfy this part of the *Complete Auto Transit* test.[226] Hence, the Court declined

218. *Id.* at 613. A tax on the value, the energy content or the method of extraction of the coal could not be easily related to services provided by the state as could a tax varying with the amount of coal mined. Lacking a measurable connection between the state tax and state-provided services present in a user fee situation, the Court in *Commonwealth Edison* could not determine if the state's severance tax was "fairly related" to state-provided services. Montana's severance tax on coal was thus summarily upheld.

219. *Id.* at 614-16.

220. *Id.* at 616 (quoting Washington Revenue Dep't v. Association of Washington Stevedoring Cos., 435 U.S. 734, 748 (1978)).

221. 430 U.S. 274 (1977).

222. 453 U.S. at 617.

223. *Id.* at 618.

224. *Id.* at 619.

225. *Id.* at 625-26.

226. *Id.* at 623; *see also* Note, *supra* note 178, at 688-92.

According to this commentator, the Court employed a three-step analysis to justify Montana's severance tax under the fourth requirement of the *Complete Auto Transit* test. Roughly, this analysis was: (1) The Court focused on the fact that the due process clause does not require that "the amount of general revenue taxes collected from a particular activity . . . be reasonably related to the value of the services provided." The Court argued that this premise to conduct a hearing on the "fairly related" prong of the *Complete Auto Transit* test, choosing to defer to the superior fact-finding capabilities of the legislature.[227]

Justice Blackmun, joined by Justices Powell and Stevens, dissented, stating that the majority incorrectly based its decision upon the issue of "whether the *measure* of the tax is fixed as a percentage of the value of the coal taken."[228] Justice Blackmun argued that under the majority's line of reasoning, "[n]o trial will ever be necessary on the issue of fair relationship so long as a State is careful to impose a proportional rather than a flat tax rate."[229]

Even Justice White, in his concurring opinion, stated: "[t]his is a very troublesome case for me, and I join the Court's opinion with considerable doubt and with the realization that Montana's levy on consumers in other States may in the long run prove to be an intolerable and unacceptable burden on commerce."[230] Despite strong reasons for striking down Montana's tax, the Court, recognizing its lack of competency to make decisions in this area,[231] stated that the "rate of taxation is essentially a matter for legislative, and not judicial, resolution."[232] The Court

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holds true even when the tax is evaluated under a commerce clause analysis; (2) The Court viewed the fourth prong ("fairly related") of the test as merely an extension of the first ("substantial nexus"). Therefore, the tax need only be assessed according to a taxpayer's *presence* in the state rather than on the *value* of the services provided by the state; (3) The Court deferred to the legislature to make the final decision since it is better equipped and uses a majoritarian decision-making process. Note, *supra* note 178, at 688-89; *see also* 125 P. KURLAND & G. CASPER, LANDMARK BRIEFS AND ARGUMENTS OF THE SUPREME COURT OF THE UNITED STATES; CONSTITUTIONAL LAW 1980 TERM SUPPLEMENT 1, 126-30 (1982) (argument that *Complete Auto Transit* test's "fairly related" requirement should have at least received hearing in *Commonwealth Edison*).

227. 453 U.S. at 626.

228. *Id.* at 645 (Blackmun, J., dissenting).

229. *Id.* (Blackmun, J., dissenting). The dissent further argued that "[u]nder the Court's reasoning any ad valorem tax will satisfy the fourth prong; indeed, the Court implicitly ratifies Montana's contention that it is free to tax this coal at 100% or even 1,000% of value should it choose to do so." *Id.* at 645-46 (Blackmun, J., dissenting).

Professor Levmore has suggested that "[t]he exploitation thus permitted by the Court's decision [in Montana] is the most harmful sort of state action involved in the commerce clause cases." Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 618 (1983).

230. 453 U.S. at 637 (White, J., concurring).

231. *See* Metropolitan Casualty Ins. Co. v. Brownell, 294 U.S. 580, 584 (1935).

232. 453 U.S. at 627. *See* McGrath & Hellerstein, *Reflections on* Commonwealth Edison Co. v. Montana, 43 MONT. L. REV. 165, 171-72 (1982); *see generally* L. TRIBE, *supra* note 17, § 5-22, at 310 n.13 (Congress is most appropriate body to determine relative allocation of powers between national and state governments).

Although in most cases a state tax should be set by the legislature, exceptions remain. For a discussion that *Commonwealth Edison Co. v. Montana* was wrongly decided see Note, *supra* note 178. The author of this Note argued that deference to the state legislature is imnoted that under our federal system the proper level of state taxes must first be determined by state legislatures and then, if necessary, by Congress.[233]

The trend has been for a court to defer to the legislature when faced with a difficult decision in the business/economic realm. The ruling in *Commonwealth Edison* allowing the legislative branch to determine the proper level of a state severance tax is just one example of this policy. The message sent by the Court is this: if the political process functions adequately in a given area, the Court will defer to the legislature's judgment.

Presently, the Court analyzes dormant commerce clause challenges to state taxes under the four-part test outlined in *Complete Auto Transit.* However, in a subsequent case, *Commonwealth Edison Co. v. Mon-*

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proper for state taxes of energy-producing resources moved in interstate commerce. When a state can fill its own coffers at the expense of out-of-state consumers, resulting legislation will be slanted in the state's favor. *Id.* at 697. In the case of a severance tax on an in-state natural resource such as in *Commonwealth Edison,* a court must step in to set the proper level of the tax. The author of this Note proposed a manageable standard of review for courts to follow.

First, because the fourth prong of the *Complete Auto Transit* test only states that taxes must be "fairly related" to the benefits provided by the state, a court need not determine that the tax paid exactly equals the cost of services provided. *Id.* at 699. "Hence, there need only be an ascertainable 'relationship,' and that relationship must be one which 'fairly' burdens the taxpayer; only approximation, not mathematical precision, is called for." *Id.* at 699-700.

Before proceeding with his or her case, the plaintiff must prove that the state tax is levied on goods "(1) moved in interstate commerce, (2) used primarily by nonresidents of the taxing state, and (3) subject to monopoly-like control by that state." *Id.* at 700. If this prima facie case is not established an irrebuttable presumption that the challenged tax is actually fairly related to the state-provided services results. *Id.* at 700-01. Assuming that this burden of production is met the plaintiff may attempt to show that the challenged tax is excessive in relation to services provided. Rough approximation is all that is necessary at this stage. If the taxpayer succeeds in demonstrating that the tax appears unduly burdensome, the burden of production shifts to the state. The state need only show that it has made a good faith attempt to fairly set the rate of the tax. *Id.* at 701-02. The court's scrutiny should be on "the process leading to the challenged result, not the result itself.... The court would, in effect, defer to the political process, reviewing taxes only to the extent necessary to prevent commerce clause violations when that process is ineffective." *Id.* at 702; *see also* Note, *supra* note 168, at 452-54; Note, *An Outline for Development of Cost-Based State Severance Taxes,* 20 NAT. RESOURCES J. 913, 922-29 (1980).

233. *Commonwealth Edison,* 453 U.S. at 628; *see also* South Carolina Highway Dep't v. Barnwell Bros., 303 U.S. 177, 191 (1938). The *Barnwell* Court stated: "courts are not any the more entitled, because interstate commerce is affected, to substitute their own for the legislative judgment." *Id.* In the case of a state tax on an energy resource being used predominately by out-of-state consumers, the state legislature may be biased in favor of state interests. Even though in this case Congress would be the most appropriate body to set the tax rate, problems may arise. Congress is notoriously slow to act and, arguably, a court should rule on the constitutionality of the state tax as an interim measure. This way interstate business would not be penalized by an unconstitutionally high tax during the period between the enactment of the tax and the passage of a congressional bill setting a fair tax rate.

tana,[234] the Court declined to even apply the fourth prong of the *Complete Auto Transit* test—that the state tax be fairly related to state-provided services. Thus, today, state taxes which are questioned under the fairly related requirement of the *Complete Auto Transit* test are automatically upheld by the Court in deference to the superior ability of the legislative branch to decide the proper level of local taxes.

B. Analysis

1. Santa Monica's franchise fee under dormant commerce clause analysis

a. proper role of the court in determining constitutionality of Santa Monica's franchise fee

Had the court in *Shell Oil Co. v. City of Santa Monica*[235] ruled that the market participant doctrine did not apply, the City of Santa Monica's franchise fee would have been subject to the *Complete Auto Transit, Inc. v. Brady*[236] test for state taxes. Such a holding would have led to the question of whether, under the fairly related prong of the *Complete Auto Transit* test, the court or the state legislature is the proper body to determine the level of the franchise fee. Either body, however, is faced with the difficulty of choosing the proper criteria to judge the validity of the franchise fee. If a court performs this task, should it limit itself to a simple yes or no inquiry under the requirements of the dormant commerce clause? Or should the court go further and actually determine the exact dollar amount of the fee?

Various arguments can be made that a court should decide if the City of Santa Monica's franchise fee is properly set.[237] First, it can be asserted that judicial intervention is necessary to ensure that a fixed charge such as Santa Monica's is not simply a guise for otherwise impermissible activity. Second, if the court does rule on the fairly related nature of the city's franchise fee the court will send a message to other cities

234. 453 U.S. 607 (1981).

235. No. CV 82-2362 (C.D. Cal. June 13, 1986).

236. 430 U.S. 274 (1977).

237. Perhaps the courts should have greater power to decide economic issues. Alexis De Tocqueville, the French scholar who observed American democracy in the mid 1800's noted:

> In America the legislature of each state is faced by no power capable of resisting it. Nothing can check its progress, neither privileges, nor local immunities, nor personal influence, nor even the authority of reason, for it represents the majority, which claims to be the unique organ of reason. So its own will sets the sole limits to its action.

A. DE TOCQUEVILLE, DEMOCRACY IN AMERICA 89 (G. Lawrence Trans. Anchor Books ed. 1969).

that an excessive tax may be struck down. These other cities will then be more cautious in calculating their franchise fees, making sure that a fair and quantifiable relationship exists between the services they provide and reimbursing taxes. Finally, even if a court rules on the validity of the connection between services provided and taxes assessed, congressional action is not precluded. Congress can always override a judicial decision invalidating a state tax on dormant commerce clause grounds by expressly removing the tax from the restrictions of the commerce clause.[238]

In upholding Santa Monica's franchise fee, Judge Kelleher relied heavily upon the ruling in *Western Oil & Gas Association v. Cory*.[239] In *Cory*, the state of California had placed two distinct types of fees on oil pipelines running beneath state-owned land. One fee was based on the *volume* of *oil* actually passing through the pipeline while the other was based on a *percentage* of the appraised value of the *land* through which the pipelines ran.[240] The *Cory* court struck down the first fee because it was disproportionate to the benefits conferred upon the oil companies who owned the pipelines.[241] The court was able to do this because the fee was based on volume—it measured actual use and, therefore, could be compared to benefits received by the oil companies.[242] Conversely, the second fee was allowed to stand.[243] Presumably the court in *Cory*, relying upon the holding of *Commonwealth Edison*, reasoned that the court did not have the resources to measure the constitutionality of a fee levied for services which could not be easily measured.[244]

238. "Given their origin as negative judicial inferences from a constitutional grant of power to Congress, the Supreme Court's doctrinal limitations on state interference are always subject to congressional revision." L. TRIBE, *supra* note 17, § 6-2, at 321. *See* Prudential Life Ins. Co. v. Benjamin, 328 U.S. 408 (1946). In *Prudential Life*, Congress had passed the McCarren Act which provided that "silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States." *Id.* at 429. The Court in *Prudential Life* held that the McCarren Act exempted a South Carolina tax on only out-of-state insurance companies even though this tax would otherwise not have survived judicial review under the dormant commerce clause.

239. 726 F.2d 1340 (9th Cir. 1984), *aff'd*, 471 U.S. 81 (1985) (4-4 decision).

240. 726 F.2d at 1341-42.

241. *Id.* at 1344-45.

242. *Id.* at 1344. The court stated that the fee based on volume was not justifiable as a means of compensating the state for: (1) improvements to the land, (2) services or facilities, or (3) environmental damage caused by the use of the pipelines. The court held that the fee violated the commerce clause because it was a disguised revenue raising measure. For cases concerning "user" fees designed to reimburse the state for the use of state-owned or state-provided transportation or other facilities and services, see Evansville-Vanderburgh Airport Authority Dist. v. Delta Airlines, Inc., 405 U.S. 707 (1972); Clark v. Paul Gray, Inc., 306 U.S. 583 (1939); Ingels v. Morf, 300 U.S. 290 (1937).

243. 726 F.2d at 1343-45.

244. The *Cory* court never discussed the validity of the percentage fees one way or the

The policy behind the decisions in *Cory* and *Commonwealth Edison* also applies to the facts in *Shell.* A court is ill-equipped to determine whether a fixed charge such as Santa Monica's franchise fee actually reimburses the city only for services it provides. Also, the wording of the *Complete Auto Transit* test, i.e., whether the tax is fairly related to state-provided services, is sufficiently ambiguous to deny a court any meaningful guidelines. Deference to the state legislature or Congress is the proper choice for a court in this situation.[245]

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other. Judge Kelleher, in *Shell,* pointed out what he thought would have been the inevitable result had the *Cory* court reached the issue. *See Shell,* No. CV 82-2362 at 9, 11.

245. Such deference may be an outgrowth of the Court's tendency in recent years to abstain from judicial intervention in purely economic affairs. In United States v. Carolene Prods. Co., 304 U.S. 144 (1938), the Court declared that it would uphold a regulation dealing with economic matters against substantive due process attack if there were any rational basis for the law. *See* Ferguson v. Skrupa, 372 U.S. 726 (1963); Williamson v. Lee Optical of Okla., Inc., 348 U.S. 483 (1955). The Court has also removed business' shield from legislation in the dormant commerce clause area:

> In the absence of such legislation the judicial function, under the commerce clause as well as the Fourteenth Amendment, stops with the inquiry whether the state legislature in adopting regulations such as the present has acted within its province, and whether the means of regulation chosen are reasonably adapted to the end sought.

South Carolina State Highway Dep't v. Barnwell Bros., 303 U.S. 177, 190 (1938). See *id.* at 184-85 n.2; Southern Pac. Co. v. Arizona, 325 U.S. 761, 767-68 n.2 (1945) for footnotes discussing the importance of a system of internal political restraints. This deference extends also to actions taken by Congress in its capacity to make laws necessary and proper to regulate commerce. *See* United States v. Darby, 312 U.S. 100 (1941) (child labor banned pursuant to federal statute); NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937) (unfair labor practices held illegal pursuant to National Labor Relations Act).

This policy of judicial abstention does not extend to all non-economic affairs, however. Justice Stone's famous footnote four in *Carolene Products* was later used as justification for the Court's ability to strike down laws affecting racial minorities, aliens and other classes not adequately represented in the political process. 304 U.S. at 149 n.4. *See* Lusky, *Footnote Redux:* A Carolene Products *Reminiscence,* 82 COLUM. L. REV. 1093 (1982); Powell, Carolene Products *Revisited,* 82 COLUM. L. REV. 1087 (1982).

In the commerce clause context, the Court tends not to interfere with a state legislative scheme if all parties have access to proper representation in the political process. Thus, the Court emphasizes the non-discrimination aspect of the dormant commerce clause analysis; if a disproportionate percentage of those affected are out-of-staters, then the normal system of legislative checks and balances does not operate.

> If the local measure, even under the guise of a more recent legitimate goal, attempts to afford residents an economic advantage at the expense of a free-flowing national market, the countervailing national interest will override. But even local economic measures are more likely to be upheld if there is no discriminatory purpose or effect.

J. NOWAK, R. ROTUNDA & J. YOUNG, *supra* note 163, § 8.9, at 286. *See* Milk Control Bd. v. Eisenberg Farm Prod., 306 U.S. 346 (1939) (Pennsylvania law setting minimum price for milk shipped in interstate commerce upheld because local consumers were equally burdened and thus political check on law existed).

The Supreme Court has also recognized that the superior fact-finding ability of Congress extends to many areas of constitutional adjudication. *See* Fullilove v. Klutznick, 448 U.S. 448 (1980) (deference to Congress' finding that particular federal spending program was necessary to remedy past discrimination); City of Rome v. U.S., 446 U.S. 156 (1980) (deference to Con-

Another policy reason for permitting the legislature to decide this issue is that oil franchise rates are not of great importance on an isolated basis. However, if more cities decide to follow Santa Monica's example,[246] the problem could be construed as statewide in magnitude and the legislature might be justified in acting.[247] Even assuming that other cities choose not to adopt sufficiently oppressive fees to trigger statewide action, the importance of encouraging the construction and maintenance of oil pipelines might provide an adequate reason for the legislature to pass such laws. Specifically, such legislation would invite the oil companies to build large inter-city pipelines without the fear that one city might later thwart the viability of the project. Also, the legislature is free to consider the economic efficiency of not allowing municipalities the power to force additional pipelines to be built to compensate for segments of existing

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gress' decision to enact Voting Rights Act of 1965); Katzenbach v. Morgan, 384 U.S. 641 (1966) (deference to Congress' decision to enact § 4(e) of the Voting Rights Act of 1965 which, in effect, gave immigrants from Puerto Rico the right to vote in New York City).

246. *See supra* note 12. The City of Santa Monica's increased franchise fee is arguably a method to ensure that pipelines are routed outside of the city. The situation in *Shell* can be analogized to the "fight between the haves and the have-nots" over Occidental Petroleum's proposed drilling project in the Pacific Palisades. Robertson, *Palisades Oil is Los Angeles' Oil-Go for it!*, L.A. Times, Aug. 9, 1987, Pt. V (Opinion), at 5, col. 1. In this editorial, William Robertson, the executive secretary-treasurer of the Los Angeles County Federation of Labor, asserted that:

> the Palisades is the only area in [Los Angeles] where known oil reserves are not being produced for the benefit of all. Opponents have long enjoyed the economic benefits of safe urban drilling in other parts of the city, but when it comes to producing oil reserves in the Palisades, they want no part of it, however safe or environmentally sound.

Id. Similarly, citizens of Santa Monica drive cars and depend upon petroleum-derived products in other ways. Perhaps it is only fair that Santa Monica does its share to assist in the transportation and production of oil.

247. The permanent nature of oil pipelines complicates the analysis. It can be argued that municipalities should be allowed to set the rate of local income taxes because different tax levels merely add to the "competitive advantages and disadvantages . . . inherent in the existence of separate local entities . . . ." Sato, *"Municipal Affairs" in California*, 60 CALIF. L. REV. 1055, 1099-1102 (1972). Thus, a business dissatisfied with the tax rates in one city can simply redirect its focus to another city.

Oil pipelines may deserve special consideration because of the manner in which they are installed. It costs a great deal of money to dig up an oil pipeline and reroute it. Conceivably cities will be able to charge franchise fees up to the level of this removal cost. To avoid this type of unfair overtaxation the legislature may want to impose limits upon oil pipeline franchise fees.

At the same time, however, cities such as Santa Monica can claim that there is no method to accurately determine a franchise fee which will adequately compensate the city for unforeseen dangers. The possibility that pipeline explosions or other less noticeable health hazards may occur provides an excellent reason to err on the side of overcharging for a pipeline franchise.

pipelines shut down because of fee disputes.[248]

Despite the real danger that cities will enact fixed fees in order to avoid the constitutional restraints imposed upon user fees measuring actual use, the decisions in *Complete Auto Transit* and the cases following it remain valid. First, if a local governmental body obviously levied a tax for the purpose of protecting local economic interests, the tax would be struck down on commerce clause grounds.[249] Second, assuming that the tax is a legitimate exercise of a city's power, a court should not be forced to determine the fairness of the tax.

Ideally, a judge could wave a magic wand and conjure up the precise rate of a fair tax. Realistically, however, courts these days have difficulty hearing the easy cases; complex tax decisions such as the one presented in *Shell* belong in the legislative branch of government. In our system of government, courts require greater guidance when making decisions than does the legislature. Given the nature of the issue in *Shell*, no prior judicial rulings would be able to provide an adequate framework for future decisions. Because a fair franchise fee in a *Shell*-type situation is necessarily subjective, each court faced with a challenged municipal fee would have to resort to an ad hoc decision-making process. A better approach would be to wait for the legislature to pass a blanket rule applying to all oil pipeline franchise fees. Should debate arise over the interpretation or constitutionality of such a statute, then a court would be justified in stepping in to resolve the issue.

The facts in *Shell* do not indicate that the effectiveness of the political decision-making process would be diminished. In *Commonwealth Edison*, where the process arguably was damaged, the Montana legislature did not have any incentive to limit its severance tax on coal because most of the burden fell on out-of-state consumers. By contrast, under the *Shell* facts the state legislature would be representing not only the cities which have pipelines running through their property and which want the discretion to raise their rental fees, but also the consumers of oil in California cities without pipelines.[250] In addition, the oil companies can

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248. For an argument that economic efficiency arguments do not apply to judicial rulings under the dormant commerce clause see *supra* note 140 and accompanying text.

249. Baldwin v. Seelig, 294 U.S. 511 (1935) (New York state law discriminating against out-of-state milk suppliers).

250. Because oil is the lifeblood of American industry, a great deal of thought has been given to public policy in this area:

> It is possible to stipulate three general requisites of any public policy toward crude oil pipelines:
>
> (1) Acknowledging the existence of long-, intermediate-, and short-run decreasing costs in the operation of pipe lines, any acceptable public policy toward pipe lines must include provisions designed to achieve the social optimum of lowest cost per

lobby effectively in Sacramento and Washington, D.C.[251] Because any regulation or tax will not affect out-of-state residents to a disproportionate degree over in-state residents, the majoritarian decision-making process will not be inhibited. If a regulation or tax passed by the legislature did appear to overtly favor in-state interests,[252] then scrutiny by a court under the dormant commerce clause might be warranted.

b. balancing dormant commerce clause challenges to state taxes

Historically, the United States Supreme Court developed two distinct lines of dormant commerce clause analysis: one for state taxes and one for state regulations.[253] In *Shell Oil Co. v. City of Santa Monica*,[254] the City of Santa Monica's franchise fee would have been best analyzed using a tax analysis although a regulation analysis might also have applied. However, even under the dormant commerce clause test of state

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> unit by encouraging the construction of the largest possible lines in any particular area. Because of the uneconomic higher costs (and therefore wasted resources) which arise from carrying oil in small quantities, any policy must be rejected if it encourages the construction of several small lines where one large line could be used.
>
> (2) All companies desiring access to the lines should have the right there to both initially and permanently guaranteed, in order that there can be no valid grounds for charges that the owners of the lines use them to control the producing and/or refining stages of the industry. Not only should there be guaranteed access, there should also be equalized costs for all companies using the lines.
>
> (3) These two goals of any pipe-line public policy should be achieved with the least possible amount of regulatory effort. Indeed, should appreciable regulation be necessary, it would become necessary to balance the social desirability of least-cost operation and equal access against the undesirability of regulation.

L. COOKENBOO, CRUDE OIL PIPELINES AND COMPETITION IN THE OIL INDUSTRY 128 (1955).

251. Shifting the decision-making authority to the state legislature is a simple solution only from the court's viewpoint. Even though the legislature is better equipped than the court to undertake a detailed factual analysis of the problem, the legislature still requires a decisional framework. Possibly the state legislature could expand upon the "fairly related" requirement of the *Complete Auto Transit* test by performing the fact-finding necessary to determine what a "fair" fee is. The legislature could take the user fee and tax cases as a starting point but would not be limited to a strictly constitutional analysis, as a court is. *See generally* Metropolitan Casualty Insurance Co. v. Brownell, 294 U.S. 580, 584 (1935) (Congress does not have the same limitations on its decision-making process as the courts). What is "fair" for a court does not necessarily equal what is "fair" for a legislature. The Supreme Court clearly indicated in the cases following *Complete Auto Transit* that legislatures are essentially free from dormant commerce clause restraints when deciding the proper level of a state tax. *See supra* note 215.

252. *See* Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951) (local statute discriminating against out-of-state milk producers struck down because of availability of less discriminatory alternatives).

253. The analysis used in challenges to state regulations under the dormant commerce clause could possibly apply to challenges to state taxes as well. L. TRIBE, *supra* note 17, § 6-14, at 344, 345 n.3.

254. No. CV 82-2362 (C.D. Cal. June 13, 1987).

regulations, Santa Monica's franchise fee probably would have passed judicial scrutiny.

The dormant commerce clause test for challenged state taxes and the dormant commerce clause test for state regulations both involve due process and commerce clause concerns. The first two prongs of the *Complete Auto Transit* test for state taxes—(1) that there be a sufficient nexus between the state and the taxed activities; and (2) that the tax be fairly apportioned—are related primarily to due process concerns of fairness and reasonableness.[255] The establishment of this minimum contact between the taxing state and the taxed entity ensures that businesses conducting interstate commerce will not be subject to taxes by states with which they have little or no connection.[256]

Arguably, the fourth requirement of the *Complete Auto Transit* test was enacted to ensure that commercial enterprises engaged in interstate commerce exactly compensated state governments for the use of state-provided services. However, later cases interpreted this fourth requirement as merely an outgrowth of the first two prongs.[257] Thus, the bulk of the Court's present analysis for state taxes challenged under the dormant commerce clause involves due process standards.

The first two prongs of the standard judicial test for state regulations under the dormant commerce clause, like the test for state taxes, concern due process.[258] The first requirement of the state regulations test is that the state have a legitimate purpose for the regulation,[259] and the second requirement is that there be a rational relationship between the law and this state purpose.[260] Apparently, the first, second and fourth prongs of the *Complete Auto Transit* test for state taxes are roughly equivalent to the first two requirements of the standard test of state regulations under the dormant commerce clause. The emphasis in each case is on a certain required level of reasonableness underlying the state tax or regulation to comport with the due process clause.

Both the non-discrimination requirements of the *Complete Auto Transit* test for state taxes and the test for state regulations reflect the commerce clause policy of equal treatment of in-state and out-of-state interests. The third prong of the *Complete Auto Transit* analysis asks

255. Sedler, *The Negative Commerce Clause*, *supra* note 213, at 912-13.

256. *Id.*

257. *Commonwealth Edison*, 453 U.S. 609, *Cory*, 726 F.2d 1340 (9th Cir. 1984). *See* Note, *supra* note 178, at 683.

258. For an outline of the dormant commerce clause test for state regulations, see *supra* note 51.

259. *Barnwell Bros.*, 303 U.S. at 190.

260. *Id.*

that the state tax not discriminate against interstate commerce while the fourth requirement of the standard state regulations test questions whether the state has used the least discriminatory alternative. The rationale behind either test is to ensure that local businesses do not enjoy a state-enforced advantage over out-of-state enterprises conducting interstate operations.[261]

The balancing requirement of the dormant commerce clause test for state regulations, a major element of that test, is absent from the *Complete Auto Transit* test for state taxes.[262] One explanation for the absence of a balancing of state benefits and commercial burdens is that the United States Supreme Court has pre-balanced the conflicting interests in a tax situation. Perhaps, this definitional balancing has led to a test which can be applied to all cases falling in the same category as opposed to ad hoc balancing where the interests are weighed on a case by case basis. For instance, in the free speech area, certain types of offensive words have been deemed by the Court to be "of such slight social value as a step to truth that any benefit that may be derived from them is clearly outweighed by the social interest in order and morality."[263] Under a definitional balancing approach, these words are assumed to be subject to prior restraints by the state while prior restraints on other classes of words have to be decided individually.

In the state tax cases, the state's interest is always the same: compensation for state-provided goods or services. Likewise, on the other side of the scale, the burdens upon entities conducting interstate operations remain constant. These burdens upon interstate commerce are the

261. For an argument that both the *Complete Auto Transit* test for state taxes and the dormant commerce clause test for state regulations are conceptually justified only upon the nondiscrimination aspect of the dormant commerce clause, see Sedler, *supra* note 213.

262. There is a fifth prong to the dormant commerce clause test for state regulations: whether the state law has an extraterritorial effect. The state tax's most serious extraterritorial effect would likely result from an improperly apportioned tax. *See* Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573 (1986) (New York law that prohibited liquor distributors from selling liquor in other states at a lower price than in New York violated dormant commerce clause); see also *supra* note 51. Compliance with the second and third prongs of the *Complete Auto Transit* test would probably eliminate any adverse effects of the tax outside of the taxing jurisdiction. *See* text accompanying note 212.

The franchise fee in *Shell* did not have the effect outside of the state that the New York law in *Brown-Forman* had. Santa Monica's actions in *Shell* did not regulate out-of-state transactions because the taxed activity in *Shell* took place entirely within the state. The extraterritorial effect test was designed to prevent one state from regulating activity in another state; even if the transportation of Shell's oil through the pipeline is assumed to be interstate commerce, no state outside of California is effected to the degree necessary to trigger the test used in *Brown-Forman*.

263. Chaplinsky v. New Hampshire, 315 U.S. 568, 572 (1942).

danger of overtaxation and the hindrance to interstate commerce caused by the efforts necessary to collect the taxes—the compliance factor. Because the relative weight of the interests on both sides of the balance remain much the same in all tax cases, an ad hoc balancing of the interests is not required in individual tax cases. Thus, the Court's test of state taxes as delineated in *Complete Auto Transit* concentrates only on whether the taxed entity has sufficient contacts with the taxing state to satisfy due process concerns, and whether the discrimination proscribed by the dormant commerce clause is absent. The ad hoc balancing performed in the normal dormant commerce clause test of state regulations is not needed where state taxes are concerned because the balance would not vary substantially with each case.[264]

Even if the City of Santa Monica's franchise fee in *Shell* was scrutinized under the dormant commerce clause test for state regulations, the fee would probably be upheld. Santa Monica's franchise fee would easily pass the first two prongs of the state regulations analysis; these two prongs comprise a due process rational basis test which is very deferential to the state's interests. Santa Monica arguably has several legitimate reasons for enacting its fee upon Shell's oil pipeline. Included among these reasons are: (1) concern for the health and safety of Santa Monica citizens, and (2) the right to compensation for city-provided services. The franchise fee is rationally related to the first reason because the increased revenues might discourage the oil company from renewing the franchise, thereby eliminating the potential danger of pipeline explosion. The franchise fee is rationally related to the second reason because the increased revenues would pay for past and future city services. Santa Monica's franchise fee would also pass muster under the requirement that the state use the least discriminatory alternative. Under Santa Monica's franchise fee both intrastate and interstate oil pipelines were treated identically.[265]

The satisfaction of these three prongs would leave only the balancing of state and commercial interests element. In *Shell*, the franchise fee would still have been upheld even if Santa Monica's interest in gaining compensation for city-provided services was outweighed by the tax burden upon interstate commerce. A court could not strike down Santa Monica's franchise fee under a dormant commerce clause balancing test for two reasons. First, just as a court is not equipped to determine if a state tax is fairly related to state-provided services as required by the fourth prong of the *Complete Auto Transit* test, a court cannot judge the

264. *See* notes 168-71 and accompanying text.
265. Appellee's Answering Brief, *supra* note 11, at 28.

level of overtaxation present for purposes of a balancing test. Second, assuming that the burden upon interstate commerce clearly outweighed the benefits to Santa Monica,[266] the court should still be reluctant to interfere with cases in the business/economic realm in which none of the actors historically has been underrepresented in the political process.[267]

In summary, the result in *Shell* would be identical under either the *Complete Auto Transit* tax case approach or the standard test used for dormant commerce clause challenges to state regulations. Because a commercial enterprise such as Shell Oil Co. can obtain an adequate voice in the state legislature or in Congress, the court should not strike down Santa Monica's franchise fee. Instead of deciding whether the franchise fee is fairly related to city-provided services under a tax approach or whether the burden to interstate commerce outweighs the benefits to Santa Monica under a regulations approach, the court must defer to the legislative branch.

2. The state legislature and local franchise fees

Judge Kelleher's deferral of the problem of determining the proper rate of local franchise fees to the state legislature did not solve the dilemma; it merely shifted it to another decision-making body. This section examines how current California statutes address the oil pipeline franchise issue and then discusses whether this law applies to the City of Santa Monica's franchise agreement with Shell Oil Co.[268] Finally, a

266. The courts will use the balancing test in dormant commerce clause cases only where one interest clearly outweighs the other. If a somewhat equal balance exists between the competing interests, courts generally do not feel comfortable in performing the balancing test. Southern Pac. Co. v. Arizona, 325 U.S. 761 (1945) (state regulation prohibiting operation of trains exceeding set number of cars violated dormant commerce clause).

Rarely, the courts will perform an additional test when both sides of the balance are roughly equal. In Kassel v. Consolidated Freightways Corp., 450 U.S. 662 (1981), the Court asked whether the state could have accomplished the same result in a less burdensome manner. This interpretation of the dormant commerce clause balancing requirement makes passing this part of the test very difficult. Moreover, it is probably equally difficult for a court to decide whether a state regulation could have accomplished the state's goal in a less burdensome fashion as it is for a court to determine whether a state tax is fairly related to state-provided services. *See* notes 204-35 and accompanying text.

267. L. TRIBE, *supra* note 17, § 6-5, at 327 & n.7. *See* South Carolina State Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938) (state highway regulation barring most commercial trucks upheld because intrastate as well as interstate shippers were equally affected).

268. A detailed and comprehensive analysis of California state law involving the oil pipeline franchise fee issue is beyond the scope of this Note. The purpose of this section is merely to acquaint the reader with the potential for conflict: (1) between federal and state/local law; (2) between state and local laws. Although this Note deals mainly with federal law, in particular the commerce clause, it is wise to remember that federal, state and local laws exist concur-

modest proposal is offered for model legislation dealing with the situation.

a. present legislation

Section 6202 of California's Franchise Act of 1937 grants to the legislative body of state municipalities the power to

> grant a franchise to any person, firm, or corporation, . . . to use, or to lay and use, pipes and appurtenances for transmitting and distributing oil or products thereof for all purposes, . . . under, along, across, or upon the public streets, ways, alleys, and places within the municipality, upon the terms and conditions provided in this chapter.[269]

Under section 6203 of the Act, local decision-making bodies may "in such a franchise impose such other and additional terms and conditions not in conflict with this chapter, whether governmental or contractual in character, as in the judgment of the legislative body are to the public interest."[270] Taken together, sections 6202 and 6203 enable cities and other state subdivisions to enter into contractual agreements with oil companies to construct and use oil pipelines running beneath public streets.

The rate of local franchise fees on oil pipelines is to be calculated in accordance with section 6231 of the 1937 Act. The pertinent language reads:

> Notwithstanding any other provision of this section, if the application is for a franchise for a nonpublic utility pipeline for industrial gas or oil or products thereof, the application shall state that the applicant, if granted the franchise, will pay to the municipality during the life of the franchise either a specified percentage agreed to by the applicant and the municipality of the gross annual receipts of the applicant arising from the use, operation, or possession of the franchise or an annual franchise fee in an amount agreed to by the applicant and the municipality or an annual franchise fee computed by multiplying the sum of one-half cent ($ 0.005) times the nominal internal diameter of the pipe, expressed in inches, times the number of lineal feet of the pipe within the public streets, ways, alleys, or other pub-

rently. An oil pipeline such as the one at issue in *Shell* is potentially subject to many of these laws giving rise to both federal and state preemption problems.

269. CAL. PUB. UTIL. CODE § 6202 (West Supp. 1987) (the reference to an oil franchise was added in the 1965 amendment).

270. *Id.* § 6203 (West 1965).

lic places within the municipality.[271]

This statute offers three options for payment for an oil pipeline franchise: (1) a percentage of gross annual receipts; (2) a negotiated annual fee; and (3) a predetermined statutory formula. If section 6231 governed Shell Oil Co.'s franchise for its pipeline running through Santa Monica, only the last option could apply. The first two payment alternatives depend upon agreement by both parties—agreement did not occur in *Shell.* Under section 6231 the parties' failure to agree upon a percentage of receipts or an annual fee permits the third option, a savings clause, to come into force. The franchise fee in *Shell,* calculated according to option three, would have been $1029.60 per year.[272]

This franchise fee calculation from section 6231 would have permitted the City of Santa Monica to levy a mere $1000 annual fee upon Shell's oil pipeline in the absence of "home rule" in state-local government relations.[273] The home rule approach permits local decision-making through provisions in the state constitution.[274] The California Constitution grants municipalities designated as charter cities the right to follow home rule principles.[275] In fact, section 6205 of the Franchise Act

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271. *Id.* § 6231 (West Supp. 1987) (emphasis omitted).

272. The computation is as follows:

$0.005 × 10 inches × 3.9 miles × 5,280 feet/per mile = $1029.60. *See supra* note 10 and accompanying text.

273. The "home rule" concept in California allows local governments to decide their own fate regarding matters of strictly local concern. Normally, provisions in the state constitution delineate not only which local bodies are given home rule, but also under what conditions these local bodies can exercise home rule. *See* Vandlandingham, *Municipal Home Rule in the United States,* 10 WM. & MARY L. REV. 269 (1968).

274. J. FORDHAM, LOCAL GOV'T LAW 70-71 (1975); *see generally* Januta, *The Municipal Revenue Crisis: California Problems and Possibilities,* 56 CALIF. L. REV. 1525, 1545-46 (1968); Peppin, *Municipal Home Rule in California: I,* 30 CALIF. L. REV. 1 (1941); Peppin, *Municipal Home Rule in California: II,* 30 CALIF. L. REV. 272 (1942); Peppin, *Municipal Home Rule in California: III,* 32 CALIF. L. REV. 341 (1944); Peppin, *Municipal Home Rule in California: IV,* 34 CALIF. L. REV. 644 (1946).

275. In California, the state constitution provisions for home rule distinguish between "state concerns" and "municipal affairs." CAL. CONST. art. XI, § 5; J. FORDHAM, *supra* note 274, at 72-73; *see* Comment, *The Municipal Occupational Tax: A Source of Revenue for the Central City,* 10 U.C. DAVIS L. REV. 185, 198-202 (1977) (discussion of state preemption). The inability of courts to adequately make this distinction when deciding which matters are subject to home rule resembles the problems plaguing courts in other areas. The difference between state/municipal concerns is often just as nebulous as the local/non-local distinction in the early state tax cases or the sovereign/proprietary distinction extending to many areas of constitutional adjudication. *See* Sato, *"Municipal Affairs" in California,* 60 CALIF. L. REV. 1055 (1972) (summary of California home rule cases). For a discussion of the local/non-local distinction, see *supra* notes 175-80 and accompanying text; of the sovereign/proprietary distinction, see *supra* notes 141-63 and accompanying text.

To reduce the role of the courts in interpreting home rule provisions, Dean Fordham of 1937 expressly states that "[t]his chapter does not apply to any municipality having a freeholder's charter adopted and ratified under the [California] Constitution and having in such charter provisions for the issuance of franchises. . . ."[276] Santa Monica is a charter city; the Santa Monica City Charter has a section dealing with the granting of franchises,[277] and, therefore, the city is not governed by the predetermined formula set forth in section 6231.[278]

Although the Franchise Act of 1937 presently excludes the City of Santa Monica from the franchise restrictions imposed upon general law

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proposed a form of constitutional home rule, referred to as "legislative" home rule. "Under this form of home rule, the constitution grants local governments all powers the legislature is capable of delegating, but the legislature is authorized to withdraw or limit home rule powers by statute." D. MANDELKER, D. NETSCH, P. SALSICH, STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM 101 (1977). In states which have adopted "legislative" home rule, courts do not have to decide if the "municipal concern" exception applies to exempt local ordinances from preemption by state law.

276. CAL. PUB. UTIL. CODE § 6205 (West 1965). Section 6205 reflects the State Assembly's intent to permit charter cities to enter into franchise agreements without the constraints imposed upon general law cities:

> [N]othing contained in this chapter shall restrict the right of any such chartered municipality to avail itself of the provisions of this chapter wherever it may lawfully do so. The provisions of this chapter relating to the payment of a percentage of gross receipts shall not be construed as a declaration of legislative judgment as to proper compensation to be paid a chartered municipality for the right to exercise franchise privileges therein.

Id.

In fact, the California Supreme Court has specifically declared that "the power to tax for local purposes clearly is one of the privileges accorded chartered cities by the home rule provision of the California Constitution." Weekes v. City of Oakland, 21 Cal. 3d 386, 392, 579 P.2d 449, 452, 146 Cal. Rptr. 558, 561 (1978). At the same time, however, the home rule provision in the California Constitution "contains express language of preemption making local home rule powers 'subject to general law' " in matters of state-wide concern. D. MANDELKER, D. NETSCH, P. SALSICH, STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM 104-05 (1983). *See* CAL. CONST. art. XI, § 5(a). Therefore, the crucial question is whether a court will find that a city's oil pipeline franchise fee is a subject of exclusively local or of state-wide concern.

277. Santa Monica City Charter art. XVI—Franchises. Pertinent parts of this article state:

> The City Council is empowered to grant by ordinance a franchise to any person, firm or corporation . . . to use the public streets, ways, alleys and places . . . necessary or convenient for traversing any portion of the City for the transmitting or conveying of any service elsewhere. The City Council may prescribe the terms and conditions of any such grant.

Id. § 1600.

A later part of article XVI prescribes payment terms for such franchises:

> [T]he grantee shall . . . agree to . . . [p]ay to the City during the life of the franchise, a percentage, to be specified in the grant, of the gross annual receipts of the grantee within the limits of the City, or such other compensation as the City Council may prescribe in the grant.

Id. § 1605(e).

278. *See* The Pines v. City of Santa Monica, 29 Cal. 3d 656, 630 P.2d 521, 175 Cal. Rptr. 336 (1981).

cities, the State Assembly conceivably may decide to override Santa Monica's franchise fee.[279] By making explicit its intention to govern contractual arrangements concerning oil pipelines running through California charter cities, the Legislature could expressly preempt charter city oil pipeline franchise fees.[280]

b. proposal for state legislation

The California State Assembly could take two possible courses of

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279. It is not entirely clear, however, that the state legislature has this power. Under the charter city provisions of the California Constitution, the State Assembly may regulate only matters in charter cities which are of statewide concern or of shared state and local concern. CAL. CONST. art. XI, § 5. Anything of a strictly local nature is reserved to the city council or its equivalent. The problem is that "no exact definition of the phrase 'municipal affairs' can be formulated." 45 CAL. JUR. 3D *Municipalities* § 99, at 172 (1978).

The most satisfactory general definition of local affairs is limited to statements such as, " 'municipal affairs' has reference to the internal business affairs of a city." *Id.* at 173 (citing Fragley v. Phelan, 126 Cal. 383, 58 P. 923 (1899); Walnut Creek v. Silveira, 47 Cal. 2d 804, 306 P.2d 453 (1957); Griffin v. Los Angeles, 134 Cal. App. 763, 26 P.2d 655 (1933)). The state legislature influences the courts' decision whether a particular activity is of municipal or statewide concern because judges look to legislative intent. However, the final decision on this matter is left to the courts. "[T]he legislature is empowered neither to determine what constitutes a municipal affair nor to change such an affair into a matter of statewide concern." 45 CAL. JUR. 3D *Municipalities* § 99, at 174 (1978) (citing Bishop v. San Jose, 1 Cal. 3d 56, 460 P.2d 137, 81 Cal. Rptr. 465 (1969)).

The local/statewide status of inter-city oil pipelines has not been decided by the courts although secondary use of streets for poles and telephone wires has been held to be a municipal concern. Sunset Tel. and Tel. Co. v. Pasadena, 161 Cal. 265, 282, 118 P. 796, 803-04 (1911). Therefore, a state law designed to regulate the levels of oil pipeline franchise agreements in charter cities would arguably be valid.

280. See *In re* Carol Lane, 58 Cal. 2d 99, 372 P.2d 897, 22 Cal. Rptr. 857 (1962) and Pipoly v. Benson, 20 Cal.2d 366, 125 P.2d 482 (1942) for cases dealing with California statutes that failed to expressly preempt local law. *See generally* J. FORDHAM, *supra* note 274, at 87-88.

The obvious legal challenge to state legislation preempting local franchise fees or taxes on oil pipelines would be that such legislation involves an area not of state-wide concern. Matters which are truly municipal in scope are reserved under the California Constitution to local decision-making bodies. Januta, *supra* note 274, at 1545. Because federal statutes are not subject to being overridden by local ordinances in areas of purely "municipal concern," a law passed by Congress would have little problem preempting Santa Monica's franchise fee ordinance. *See generally* Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985) (no immunity from federal legislation for state activity in areas of traditional state governmental functions).

A related issue is whether the City of Santa Monica, faced with state or federal law purporting to regulate the oil pipeline franchise fee, could refuse to renew the franchise altogether. The City may be able to refuse to deal with Shell based on the fact that the existing pipeline is environmentally hazardous and poses a potential threat to human life. Although state or federal law may govern Santa Monica's franchise fee in the event the City decides to enter into such a contractual relationship, it is debatable that state or federal law can compel a city to enter into a franchise agreement. *See* notes 124-25 and accompanying text. The issue has not been litigated, but is likely to arise if legislation preempting Santa Monica's franchise fee agreement passes.

action to make the franchise fees of charter cities more uniform. The first is simply to extend the general law contained in section 6231 of the Franchise Act of 1937 to charter cities. A second alternative would be to enact a new law aimed specifically at municipal oil pipeline franchise fees in cities following home rule. In either case, this legislation should expressly preempt local laws.[281]

A modern statute designed to compensate municipalities and, simultaneously, not dangerously overtax oil companies should include two factors. First, the statute should automatically account for inflation by factoring in one or several national or regional indexes.[282] Second, a ceiling should be added to the statute to ensure that a certain, egregious level of taxation is not reached.[283]

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281. Express preemption is preferred because it leaves no doubt as to the legislature's intention. However, in the absence of such language, legislation may also preempt by implication. Three tests are used to determine whether the subject of a local law has been impliedly preempted by state-wide legislation:

> (1) the subject matter has been so fully and completely covered by general law as to clearly indicate that it has become exclusively a matter of state concern; (2) the subject matter has been partially covered by general law couched in such terms as to indicate clearly that a paramount state concern will not tolerate further or additional local action; or (3) the subject matter has been partially covered by general law, and the subject is of such a nature that the adverse effect of a local ordinance on the transient citizens of the state outweighs the possible benefit to the municipality.

Galvan v. Superior Ct., 70 Cal. 2d 851, 859-60, 452 P.2d 930, 935-36, 76 Cal. Rptr. 642, 647-48 (1969) (listing the three tests established in *In re* Hubbard, 62 Cal. 2d 119, 128, 396 P.2d 809, 814-15, 41 Cal. Rptr. 393, 398-99 (1964)); *see generally* California Restaurant Ass'n v. City of Los Angeles, 192 Cal. App. 3d 405, 237 Cal. Rptr. 415 (1987) (local ordinance requiring posting of health warnings at places where alcoholic beverages are sold held not to be preempted by state law).

Depending upon the state legislature's intent, it might be wise to add to a state law purporting to regulate oil pipeline franchise fees words such as: "This legislation *expressly preempts* any and all local laws including those enacted by charter law cities dealing with oil pipeline franchise fees," or "this legislation *occupies the field* of oil pipeline franchise fees in this state including those enacted by charter law cities." See Sato, *"Municipal Affairs" in California*, 60 CALIF. L. REV. 1055, 1098-99 for discussion of a case where the legislature had declared that the state had preempted the field of sales and use taxes by the enactment of the state Sales and Use Tax law.

282. Using an index to account for inflation is a good idea even if cities themselves set the fees. The Los Angeles City Council recently voted to double the fees it charges for operating underground oil pipelines, making its franchise fee "the highest charged in Southern California . . . . The 100 percent increase will boost the revenue the city earns from its 42 pipeline franchises, which cover 510 miles of underground oil pipelines citywide, to $2 million a year." *L.A. Council Doubles Fees on Oil Pipelines*, The Evening Outlook (Santa Monica, Cal.), July 16, 1987, at A3, col. 1. In addition to doubling its franchise fees, the L.A. City Council has factored inflation into the calculation. "The new fee structure is based on a complicated formula that also takes into consideration rises in the Producers Price Index." *Id.*

283. If the state legislature drafts the statute to permit a franchise fee to be set according to the value of the land the pipeline occupies, some guidelines may be necessary. Such a statute would be a viable compromise between inflexible legislation which does not allow any local

V. Conclusion

Courts should abstain from deciding whether a city's actions fall under the market participant doctrine or whether local taxes are fair under the dormant commerce clause. The arbitrary choice of whether to categorize a state's activity as governmental or as essentially private is one best kept out of the courts' hands. Because the sovereign/proprietary distinction has proved unworkable in many other areas, it has no place in determining a state's exemption from dormant commerce clause scrutiny.

Similarly, the proper level of a state's tax is a decision that a court should not be asked to make. Instead of deciding whether a local oil pipeline franchise fee is fairly related to city-provided services, a court should defer, first, to the state legislature and then, if necessary, to Congress.

*Kenneth T. Fong**

Editor's note: After this Note was sent to the printer, the Ninth Circuit handed down its decision in Shell Oil Co. v. City of Santa Monica. Shell Oil Co. v. City of Santa Monica, L.A. Daily J., Oct. 23, 1987, (D.A.R.), at 7854. The Ninth Circuit held that the market participant doctrine did not shield the City of Santa Monica from dormant commerce clause analysis. The Circuit Court compared the situation in *Shell* to that in Western Oil & Gas Ass'n v. Cory, 726 F.2d 1340 (9th Cir. 1984), *aff'd*, 471 U.S. 81 (1985) (4-4 decision): "However, like *Cory*, this case involves lands held in a sovereign capacity that are recognized transportation corridors for commerce." L.A. Daily J., Oct. 23, 1987, (D.A.R.), at 7856.

When the Ninth Circuit reached the dormant commerce clause analysis, it decided that the city's franchise fee was a user fee rather than a tax. Therefore, the dormant commerce clause tax analysis used in this Note did not apply. *Id.* at 7861 n.8. Because the franchise fee was based on an evenhanded formula using the value of land abutting the pipeline, the court upheld Santa Monica's franchise fee. *Id.* at 7857.

Shell plans to appeal the Ninth Circuit's ruling to the United States Supreme Court.

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variations and no regulation at all. For example, the statute could list various factors which the local decision-making body must consider when setting the fee. These factors could include the method to be used to determine the value of the property at issue.

* This Note is dedicated to my parents, Tom and Bonnie Fong, who have always given me their love and support.