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ESSAY

THE ANTIMONOPOLY IMPLICATIONS OF *NETCHOICE, LLC V. PAXTON*

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Much of the focus on the upcoming NetChoice, LLC v. Paxton *case has been on First Amendment theory and the imagined direct impacts of the social media laws at issue. This Essay takes a different tack, focusing not on the precedent that will inform the case, but the impacts that different proposed limiting principles could have on future legislation. There were over forty amici in support of NetChoice in these cases, and they proposed different ways to resolve the case in NetChoice's favor. This Essay discusses six limiting principles, notable for their clarity and their difference from one another. It shows how each—from the broad to the narrow, from "editorial discretion" to "right to hear"—could stymie possible antitrust legislation and rulemaking. The* NetChoice *case has significant implications for the modern antitrust movement that is supported at the top levels of the Biden administration.*

INTRODUCTION

In a series of challenges to state and federal laws, NetChoice, the advocacy arm of many "big tech" companies, including Google, Meta, Amazon, and X, is attempting to establish a new First Amendment principle. In *NetChoice, LLC v. Paxton*; *Moody v. NetChoice, LLC*; *NetChoice, LLC v. Bonta*; and other cases, the industry has argued that whenever a company engages in editorial judgment or discretion, it must receive First Amendment protections.[1] While NetChoice has not claimed that platforms are

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1. NetChoice, LLC v. Paxton, No. 22-555 (argued Feb. 26, 2024); Moody v. NetChoice, LLC, No. 22-277 (argued Feb. 26, 2024); NetChoice, LLC v. Bonta, No. 22-CV-08861, 2023 WL 6135551 (N.D. Cal. Sept. 18, 2023).

newspapers, it has claimed that platforms act like newspapers when they sort user content.[2] These cases initially sound like they fall wholly within First Amendment discourse and are not particularly relevant for antimonopoly legislative and regulatory efforts. However, classifying them as solely speech cases and not also as antimonopoly cases, represents a basic categorical error. Some of the statutes they challenge are grounded in a long antimonopoly tradition of using nondiscrimination laws. And if NetChoice succeeds in persuading the courts of its proposed standard, it will deal a significant blow to major antimonopoly legislation. In other words, a bad decision at the cutting edge of the new antimonopoly turn in American politics could have a substantial impact on the ability to constrain increasingly all-powerful companies. The primary cases in this agenda involve statutes in Florida and Texas that ban social media platforms from engaging in viewpoint-based discrimination.[3] The Florida law makes it illegal to take down or suppress any user posts regarding a candidate running for office.[4] The Texas law makes it illegal to treat user-generated content differently based on viewpoint.[5]

Because of the unsavory politics of Texas Attorney General Ken Paxton and Florida Governor Ron DeSantis, many liberal or liberal-aligned groups reflexively oppose these laws.[6] However, while these laws may be clumsily drafted and critics are correct that the politicians are using them to attack what they perceive as "woke" moderation by social media platforms,[7] a Supreme Court decision that the laws are unconstitutional would reverberate far beyond the particulars of the case and would have significant impact on progressive legislation.

State nondiscrimination laws prohibiting differential treatment of counterparties have been central to the antitrust movement since its inception.[8] These laws have been upheld in dozens of circumstances, from viewpoint discrimination bans in employment to viewpoint discrimination bans in proxy statements,[9] and they are more important today than at any time in history, as surveillance technologies, algorithmic learning,

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2. *See* Brief for Petitioners at 42–43, NetChoice, LLC v. Paxton, No. 22-555 (Nov. 30, 2023).

3. NetChoice, LLC v. Paxton, 49 F.4th 439, 444–46 (5th Cir. 2022), *cert. granted in part*, 144 S. Ct. 477 (2023); NetChoice, LLC v. Fla. Att'y Gen., 34 F.4th 1196, 1205–07 (11th Cir. 2022), *cert. granted in part sub nom*. Moody v. NetChoice, LLC, 144 S. Ct. 478 (2023).

4. S.B. 7072, 2021 Leg., Reg. Sess. § 2(2) (Fla. 2021).

5. H.B. 20, 87th Leg., 2d Sess., sec. 7, § 143A.002(a) (Tex. 2021).

6. For instance, the Electronic Frontier Foundation. *See, e.g.*, Katya Diaz, *The Fight Continues over Texas' Controversial Social Media Law*, GOV'T TECH. (May 20, 2022), https://www.govtech.com/policy/the-fight-continues-over-texas-controversial-social-media-law [https://perma.cc/7VBZ-7PMN].

7. *See* Daphne Keller, *Platform Transparency and the First Amendment*, 4 J. FREE SPEECH L. 1, 6, 23–24 (2023); Corbin Barthold, *The Right's New Legal Crusade Against Corporate Free Speech*, BULWARK (Nov. 30, 2021), https://www.thebulwark.com/p/the-rights-new-legal-crusade-against-corporate-free-speech [https://perma.cc/HRG6-AYPQ] (highlighting conservative efforts against social media operators as attempts to reign in "woke corporate speech writ large").

8. *See generally* BARRY C. LYNN, LIBERTY FROM ALL MASTERS: THE NEW AMERICAN AUTOCRACY VS. THE WILL OF THE PEOPLE (2020).

9. For instance, Minnesota bans viewpoint-based employment discrimination. MINN. STAT. ANN. § 10A.36 (West 2024). *See generally* Eugene Volokh, *Private Employees' Speech and Political Activity: Statutory Protection Against Employer Retaliation*, 16 TEX. REV. L. & POL. 295 (2012) (cataloging statutes).

and artificial intelligence allow companies to discriminate in real time among users, workers, and counterparties.[10]

Therefore, the implications of this case for the nascent American antimonopoly movement are significant. One of the most important accomplishments of the Chicago School of antitrust,[11] epitomized by Judge Robert Bork but extending over the last half century, was to change the way we categorized antimonopoly laws.[12] Historically, antitrust or "breakup" tools and nondiscrimination tools were inextricably intertwined as the two most powerful methods for combating excessive corporate power.[13] Now that the Chicago School's influence is waning, antitrust and nondiscrimination are coming back together again.[14] As the Open Markets Institute, which filed an amicus brief on behalf of Texas and Florida, argues, it is a critical time for greater common carriage enforcement, not less.[15]

A ruling for NetChoice would impact regulatory action, state laws, and the future of the antimonopoly movement. For these emerging laws, the *way* in which the Supreme Court decides these cases will be more important than the decisions themselves. If the Court bases a decision on a finding that social media platforms' use of "editorial discretion" or "editorial judgment" is First Amendment-protected activity, that would have radical implications for nascent efforts to regulate dangerous behavior.[16] Similarly, if the Court decides the cases on associational grounds, or right-to-hear grounds, it would be a major deregulatory blow. If the Court adopts a soft version of then-scholar, now-Justice Kagan's "purposive" test,[17] that could still

10. For instance, Uber drivers are paid differently based on their data profiles. Zephyr Teachout, *Algorithmic Personalized Wages*, 51 POL. & SOC'Y 436, 440 (2023); Veena Dubal, *On Algorithmic Wage Discrimination*, 123 COLUM. L. REV. 1929, 1970–72 (2023).

11. *See* William H. Page, *The Chicago School and the Evolution of Antitrust: Characterization, Antitrust Injury, and Evidentiary Sufficiency*, 75 VA. L. REV. 1221, 1229–30 (1989) (describing the Chicago School of antitrust analysis as developing in a single research community in the Chicago School of Economics with a set of shared ideological commitments, including "neoclassical price theory," "the principle of maximizing behavior and other conventional neoclassical conditions for equilibrium in competition and in noncompetitive market structures," "a preference for determinate models, such as the theory of cartels and the dominant firm pricing model of oligopoly," and "skepticism of other models of imperfect competition" (footnotes omitted)); *see also* Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979).

12. *See generally* ROBERT H. BORK, THE ANTITRUST PARADOX (Bork Publ'g 2021) (1978).

13. *See generally* LYNN, *supra* note 8.

14. *See, e.g.*, K. Sabeel Rahman, *The New Utilities: Private Power, Social Infrastructure, and the Revival of the Public Utility Concept*, 39 CARDOZO L. REV. 1621, 1689–92 (2018) (advocating for reviving a public utility theory of antitrust regulation rooted in early twentieth century ideals, including nondiscrimination, which had been displaced by the ascendance of the Chicago School).

15. Brief of Open Markets Institute as Amici Curiae in Support of Petitioners in No. 22-277 and Respondent in No. 22-555, at 1–3, Moody v. NetChoice, LLC, No. 22-277, NetChoice, LLC v. Paxton, No. 22-555 (Jan. 23, 2023).

16. *See* Brief of Law and History Scholars as Amici Curiae in Support of Respondents at 5, 15, 18–27, NetChoice, LLC v. Paxton, No. 22-555 (Jan. 23, 2024) [hereinafter Brief of Law and History Scholars]; *see also* Brief of Public Knowledge as Amicus Curiae in Support of NetChoice as Respondent/Cross-Petitioner at 5–6, 28–30, Moody v. NetChoice, LLC, No. 22-277, NetChoice, LLC v. Paxton, No. 22-555 (Dec. 7, 2023) [hereinafter Brief of Public Knowledge].

17. *See* Elena Kagan, *Private Speech, Public Purpose: The Role of Governmental Motive in First Amendment Doctrine*, 63 U. CHI. L. REV. 413, 472 (1996) ("[S]ome facially content-based laws pose only a

significantly weaken regulatory efforts, if only because most nondiscrimination laws are triggered by anger around particular forms of censorship and, therefore, have a viewpoint valence to the motivation.[18] On the other hand, if the Court explicitly preserves a state's right to pass nondiscrimination laws and strikes the statutes down for unconstitutional vagueness of the exceptions, or remands the cases to lower courts to determine the viewpoint of the exceptions, then the impact will be minimal.

To be clear, the Court is unlikely to act in a unified way, and it is quite possible that *NetChoice* will resemble *National Pork Producers Council v. Ross*,[19] with dozens of overlapping opinions. However, these opinions might still point in a general direction. So, I'll put the stakes bluntly: if a majority strikes the Texas law down on anything other than an exception-based analysis, that will raise significant questions about future antimonopoly regulation.

This Essay proceeds as follows. First, it reviews the long interaction between nondiscrimination laws and the antimonopoly movements of different eras. Second, it describes the key rules proposed by NetChoice, amici, and the states for reviewing the legislation. Third, it explains how a *NetChoice* ruling on either editorial discretion or right to hear could impact the nascent antimonopoly movement.

I. ANTITRUST AND NONDISCRIMINATION

In the mid-nineteenth century, as industrialization swept the country, fear of monopoly power took hold.[20] Farmers, small business owners, and progressive populists decried the outsize power accumulated in corporate trusts and demanded that the government strike down monopolies.[21] The Granger movement of the late 1870s pushed to set price ceilings on what railroads could charge for freight, because that served the movement's slogan—"Down with monopolies"—and could break the heart of railroad monopoly power by blocking its ability to exploit a chokepoint role.[22] At the same time, New York merchants, also subject to railroad price discrimination, became

slight danger of taint, so that weakening the presumption against them becomes appropriate. . . . I look at First Amendment law's two great exceptions to the rule against content-based restraints—the recognition of low-value categories of speech and the doctrine of secondary effects—and ask whether a motive-based approach can explain them. I conclude that this approach . . . provides the most coherent general account of prevailing doctrine.").

18. Public accommodations laws, in one form or another, enforce equal access to public life despite business owners' efforts to discriminate against protected groups. *See generally* Joseph William Singer, *We Don't Serve Your Kind Here: Public Accommodations and the Mark of the Sodom*, 95 B.U. L. REV. 929, 930–31 (2015).

19. 143 S. Ct. 1142 (2023).

20. *See* Richard R. John, *Proprietary Interest: Merchants, Journalists, and Antimonopoly in the 1880s*, *in* MEDIA NATION: THE POLITICAL HISTORY OF NEWS IN MODERN AMERICA 10, 11–12 (Bruce J. Schulman & Julian E. Zelizer eds., 2017) (highlighting the impetus of the antimonopoly movement for differing constituencies).

21. *See generally* JOHN F. STOVER, AMERICAN RAILROADS 115 (2d ed. 1997); BALLARD C. CAMPBELL, THE GROWTH OF AMERICAN GOVERNMENT: GOVERNANCE FROM THE CLEVELAND ERA TO THE PRESENT 69–71 (2d ed. 2015); GEORGE H. MILLER, RAILROADS AND THE GRANGER LAWS 42–58 (1971).

22. *See* Steven G. Calabresi & Larissa C. Leibowitz, *Monopolies and the Constitution: A History of Crony Capitalism*, 36 HARV. J.L. & PUB. POL'Y 983, 1060–62 (2013) (discussing the history of the Granger Movement). *See generally* MILLER, *supra* note 21.

a major lobbying force for local rules setting the right of access subject to posted intrastate rates—and eventually for passing the Interstate Commerce Act of 1887 (ICA).[23]

While part of the agenda involved what is now thought of as trust-busting, these populists also advocated for nondiscrimination laws related to grain elevators and trains, because the companies that owned the infrastructure did not treat farmers uniformly—often charging higher transport prices only to some.[24] In the 1876 case *Munn v. Illinois*, the Supreme Court had to review a state law requiring grain elevators not to discriminate among different farmers.[25] The Court upheld the law, affirming that states have the power to enact nondiscrimination laws for grain elevators and that such laws do not violate the Equal Protection Clause.[26] The Court reasoned, "Common carriers exercise a sort of public office, and have duties to perform in which the public is interested. Their business is, therefore, 'affected with a public interest' . . . ."[27]

Munn is frequently understood as the first big "common carriage" case,[28] the precursor to the vast array of public utility laws that prohibited certain businesses from discriminating and required that all counterparties be given the same price, terms, and treatment.[29] While the Illinois nondiscrimination law at issue in *Munn* did not explicitly target viewpoint discrimination, it encompassed a ban on viewpoint discrimination by requiring equal treatment for all farmers.[30]

The ICA, a decade later, was the culmination of the populist movements in the Midwest and South.[31] It recognized that federal laws would be needed to break up the power of centralized industry.[32] The ICA was the first federal antimonopoly legislation,

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23. Interstate Commerce Act of 1887, Pub. L. No. 49-104, 24 Stat. 379, *abrogated by* Interstate Commerce Commission Sunset Act of 1995, Pub. L. No. 104-88, 109 Stat. 804; *see also* LEE BENSON, MERCHANTS, FARMERS & RAILROADS: RAILROAD REGULATION AND NEW YORK POLITICS, 1850-1887, at 212 (1955).

24. *See, e.g.*, Note, *Undue Preference in Railroad Rates:* Texas & Pacific Ry. v. United States, 47 HARV. L. REV. 494 (1934); Brief of Law and History Scholars, *supra* note 16, at 12.

25. 94 U.S. 113 (1876).

26. *Id.* at 135–36.

27. *Id.* (citation omitted) (quoting Matthew Hale, *A Treatise in Three Parts*, *in* 1 COLLECTION OF TRACTS RELATIVE TO THE LAW OF ENGLAND 1, 77–78 (Francis Hargrave ed. 1787)).

28. *See, e.g.*, Lina M. Khan, Note, *Amazon's Antitrust Paradox*, 126 YALE L.J. 710, 797–98 (2017); *see also* James B. Speta, *A Common Carrier Approach to Internet Interconnection*, 54 FED. COMMC'NS L.J. 225, 256–57 (2002).

29. *See* Thomas B. Nachbar, *The Public Network*, 17 COMMLAW CONSPECTUS 67, 84 (2008) (discussing the ramifications of *Munn v. Illinois*, 94 U.S. 113 (1876)); William Boyd, *Just Price, Public Utility, and the Long History of Economic Regulation in America*, 35 YALE J. ON REG. 721, 755–61 (2018) (discussing early state public utilities regulations).

30. The 1871 Illinois law at issue in *Munn* required that "[e]very warehouseman of public warehouses of class A shall be required . . . to publish . . . a table or schedule of rates for the storage of grain" and that "such published rates . . . shall apply to all grain received into such warehouse from any person or source; and no discrimination shall be made, directly or indirectly, for or against any charges made by such warehouseman for the storage of grain." Act of Apr. 25, 1871, ch. 106, § 39, 1871 Ill. Laws 445; *Munn*, 94 U.S. at 117.

31. Interstate Commerce Act of 1887, Pub. L. No. 49-104, 24 Stat. 379 (1887). *See generally* Robert L. Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1197–1208 (1986).

32. *See* Paul Stephen Dempsey, *The Rise and Fall of the Interstate Commerce Commission: The Tortuous Path from Regulation to Deregulation of America's Infrastructure*, 95 MARQ. L. REV. 1151, 1162

preceding the Sherman Act by several years.[33] It created a new framework for government regulation of industries that tend to play a middleman role.[34] The ICA created the Interstate Commerce Commission (ICC) to ensure that carriers provided standardized prices and did not discriminate.[35] Congress ultimately imposed similar practices in other industries, including shipping, stockyards, telephony, trucking, and electricity.[36] The ICA's nondiscrimination model led, for instance, to the Communications Act of 1934, which created the Federal Communications Commission (FCC), with authority and responsibility to ensure nondiscrimination in communications networks.[37] The Telecommunications Act of 1996 is the most recent statutory law imposing nondiscrimination obligations on local phone service operators.[38] As Professor Thomas Nachbar has shown, nondiscrimination laws are ubiquitous in antimonopoly efforts.[39]

II. THE TEXAS LAW IN THE SUPREME COURT

Enter Florida Governor DeSantis and Texas Attorney General Paxton. This essay focuses on just the Texas law, because it is more clearly aligned with the antitrust tradition. As I argued in an amicus brief as part of a group of law and history scholars and the American Economic Liberties Project,

> [Texas] HB20 prohibits social media platforms from 'censoring' users or content based on viewpoint. "Censoring" is defined to include a wide range of actions such as blocking, banning, deplatforming, demonetizing, deboosting, or otherwise treating them or their content differently from other content.
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> . . .
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> HB20 has four exceptions to its default prohibition on viewpoint censorship. Under the law, platforms may censor: (1) conduct flagged by organizations for the purpose of preventing sexual exploitation of children or protecting sexual abuse survivors from ongoing harassment, (2) conduct that directly incites criminal activity or which constitutes threats of violence against individuals based on certain characteristics (such as race, color, religion,

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(2012) (noting that the ICA was the first attempt to create a federal regulatory scheme for an industry, rather than relying on the common law to prohibit discrimination by powerful industries).

33. *Id.* at 1162, 1170–71.

34. *See id.* at 1153–56 (noting how the lack of national regulation led to discriminatory transportation pricing by railroads and other middlemen transportation services). *See generally* KATHRYN JUDGE, DIRECT: THE RISE OF THE MIDDLEMAN ECONOMY AND THE POWER OF GOING TO THE SOURCE (2022).

35. Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of Regulated Industries Law*, 98 COLUM. L. REV. 1323, 1325 (1998); *see also* Interstate Commerce Act of 1887 §§ 2, 3, 11.

36. Kearney & Merrill, *supra* note 35, at 1334 (indicating that an administrative system of filing tariffs was the "appropriate approach to regulating public utility and common carrier services" and that government oversight of such markets was consistent with the ICA's "non-discrimination" goals).

37. Pub. L. No. 73-416, 48 Stat. 1064 (codified at 47 U.S.C. §§ 151–164).

38. *See* Pub. L. No. 104-104, § 260, 110 Stat. 56 (codified at 47 U.S.C. § 260) ("Nondiscrimination Safeguards—Any local exchange carrier subject to the requirements of section 251(c) . . . shall not prefer or discriminate in favor of its telemessaging service operations in its provision of telecommunications services.").

39. For a more comprehensive exploration of the history of statutory nondiscrimination laws, see Professor Nachbar's excellent overview. Nachbar, *supra* note 29, at 72–79.

ancestry, or sex), (3) content that is "unlawful expression," or (4) content that the platform "is specifically authorized to censor by federal law."[40]

The simplest way to understand the Texas statute at issue is as a straightforward nondiscrimination law, with exceptions. As I and others argued in the amicus brief,[41] the Texas law's prohibition on viewpoint discrimination would lead to the following consequences that seem like an unalloyed good: TikTok would be unable to suppress criticism of the Chinese treatment of Uyghurs,[42] Instagram would be unable to allow pro-Israel speech while denying pro-Palestinian speech,[43] and YouTube would be unable to choose which presidential candidate's supporters to promote.[44]

On the other hand, however, the Texas law could lead to truly ugly consequences. Instagram, TikTok, and YouTube would also be prohibited from banning white nationalism, anti-gay slurs, antisemitic and anti-Muslim political ideologies, and misogynistic content. Because of the way the recommendation algorithms work, where the most high-emotion content tends to get amplified,[45] content would not merely passively exist, the way it does, for example, in a mall or in a physical designated public forum. Content could be amplified and become popular. While social media companies in Texas would be allowed to remove content that violated the law, a great deal of negative, hateful, and false content violates no laws.[46] In other words, given the vast variety of topics discussed online, if the Court upholds the Texas law, platforms would be unable to make purposeful determinations based on the expressed point of view. They could still choose not to share pornography and to ban ad hominem arguments or direct insults, but given that the Supreme Court has previously concluded that discriminating between violent and nonviolent video games is viewpoint

40. Brief of Law and History Scholars, *supra* note 16, at 7–8, 7 n.3 (quoting Petition for Writ of Certiorari at 198a, NetChoice, LLC v. Paxton, No. 22-555 (Dec. 15, 2022); and then citing Petition for Writ of Certiorari, *supra*, at 201a–02a).

41. *Id.* at 8.

42. *See* Lindsay Maizland, *China's Repression of Uyghurs in Xinjiang*, COUNCIL ON FOREIGN REL. (Sept. 22, 2022, 11:30 AM), https://www.cfr.org/backgrounder/china-xinjiang-uyghurs-muslims-repression-genocide-human-rights [https://perma.cc/SN43-HVWV] (discussing the mass detainment of the Uyghur people in reeducation camps by the Chinese government).

43. *See* Letter from Sen. Elizabeth Warren to Mark Zuckerberg, CEO Meta (Dec. 14, 2023), https://www.warren.senate.gov/imo/media/doc/Meta%20Letter.pdf [https://perma.cc/V6TP-F56R] (expressing concern regarding reports that Meta suppressed Palestinian and Palestinian-related content on Instagram in the wake of the Hamas terrorist attacks in Israel on October 7, 2023).

44. S*ee, e.g.*, Paul Lewis & Erin McCormick, *How an Ex-YouTube Insider Investigated Its Secret Algorithm*, GUARDIAN (Feb. 2, 2018, 7:00 AM), https://www.theguardian.com/technology/2018/feb/02/youtube-algorithm-election-clinton-trump-guillaume-chaslot [https://perma.cc/6V7B-FXPC] (discussing a study showing that YouTube's recommendation algorithm disproportionately promoted conspiracy videos and videos supporting one candidate during the 2016 election period).

45. *See* Paul Lewis, *'Our Minds Can Be Hijacked': The Tech Insiders Who Fear a Smartphone Dystopia*, GUARDIAN (Oct. 6, 2017, 1:00 AM), https://www.theguardian.com/technology/2017/oct/05/smartphone-addiction-silicon-valley-dystopia [https://perma.cc/ND5Y-GZLM].

46. *See* Daphne Keller, *Lawful but Awful? Control over Legal Speech by Platforms, Governments, and Internet Users*, U. CHI. L. REV. ONLINE (June 28, 2022), https://lawreviewblog.uchicago.edu/2022/06/28/keller-control-over-speech/ [https://perma.cc/P2GC-BFGU].

discrimination,[47] it would be unlikely that almost any other form of differential treatment would be allowed.

A big part of the support for NetChoice outside of the information-technology industry comes from the sincere belief that the laws, as drafted, will lead to amplification of extremely toxic, negative, and harmful content. Unlike in the brick-and-mortar speech setting, where the racist stands lonely on a soapbox and people shy away from him, the views of the online, anonymous racist can be amplified. Indeed, the rise of instances of hate speech on Twitter (now called "X"), in the wake of Elon Musk's acquisition of the platform, suggest that lax content moderation enables that vitriol.[48] These trends may only be amplified by the Texas law. (It is also possible that the Texas law will leave social media to abandon all volatile content altogether.) However, the fear of the outcomes seems to focus on one short-term set of harms, while ignoring the long-term set of harms that can arise if platform self-regulation becomes enshrined as the only mode of public design regulation. As a recent hearing in the Senate Judiciary Committee on social media child sexual exploitation showed, content algorithms currently cause enormous harm.[49] While it may seem more preferable to trust social-media companies than to trust laws advocated for by Texas Attorney General Paxton, the real risk in these cases is to tie the hands of lawmakers going forward—particularly those actively seeking policy solutions to the growing mental health crisis of young people. Currently, social-media companies have immunity for the content of third parties posted on their websites.[50] Their economic incentives are not aligned with public health.

The heart of the arguments in *NetChoice* is about how to categorize the Texas law. NetChoice and most of the amici relied heavily on precedent regarding must-carry laws and right-of-reply laws.[51] They argued, in effect, that regulation of anything

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47. Brown v. Ent. Merchs. Ass'n, 564 U.S. 786, 802 (2011).

48. *See* Sheera Frenkel & Kate Conger, *Hate Speech's Rise on Twitter Is Unprecedented, Researchers Find*, N.Y. TIMES (Dec. 2, 2022), https://www.nytimes.com/2022/12/02/technology/twitter-hate-speech.html [https://perma.cc/35HE-EHFQ] (cataloguing an "alarming[ly] . . . sharp increase in hate speech, problematic content and formerly banned accounts" since Elon Musk purchased Twitter and began to change its content moderation policies).

49. *See Big Tech and the Online Child Sexual Exploitation Crisis: Hearing on S. 1199 Before the S. Comm. on the Judiciary.*, 118th Cong., 00:18:28–00:24:00, (2024) (opening statement of Sen. Dick Durbin, Chairman, S. Comm. on the Judiciary), https://www.judiciary.senate.gov/committee-activity/hearings/big-tech-and-the-online-child-sexual-exploitation-crisis [https://perma.cc/WVY5-U7GS]; Jacob Fischler, *'A Product that's Killing People': Lawmakers Chastise Social Media Giants for Harm to Kids*, MO. INDEP. (Feb. 1, 2024, 6:00 AM), https://missouriindependent.com/2024/02/01/a-product-thats-killing-people-lawmakers-chastise-social-media-giants-for-harm-to-kids/ [https://perma.cc/VDH7-5K4P].

50. *See* 47 U.S.C. § 230(c)(1) ("No provider . . . of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider."); Johnson v. Arden, 614 F.3d 785, 791 (8th Cir. 2010) (following circuit majority reading Section 230 "to establish broad 'federal immunity to any cause of action that would make service providers liable for information originating with a third-party user of the service'" (quoting Almeida v. Amazon, Inc., 456 F.3d 1316, 1321 (11th Cir. 2006))).

51. *See* Petition for Writ of Certiorari, *supra* note 40, at 104a–36a; Brief for Respondents at 44, Fla. Att'y Gen. v. NetChoice, LLC, No. 22-277 (Nov. 30, 2023); Brief of the Knight First Amendment Institute at Columbia University as Amicus Curiae in Support of Neither Party at 7–9, Moody v. NetChoice, LLC, No.

related to content moderation is a burden on the speech rights of the corporate actors.[52] In response, the States (and amici, including yours truly) argued that right-of-reply statutes are unlike nondiscrimination laws in essential ways.[53] Much of the debate centered around how to read the 1974 case *Miami Herald Publishing Co. v. Tornillo*.[54] There, the Florida right-of-reply statute provided that if a political candidate "is assailed regarding his personal character or official record by any newspaper, the candidate has the right to demand that the newspaper print, free of cost to the candidate, any reply the candidate may make," and that the reply must be "in as conspicuous a place and in the same kind of type" as the initial charge.[55] The statute clearly made a state judgment about kinds of content (character assailing) that required reply and could hardly be understood as viewpoint neutral, and the statute did not rely on comparative terms—the reply was not compared to other types of letters to the editor.

This Essay only touches briefly on the precedential exploration of these arguments or the theoretical underpinnings and focuses, instead, on the antimonopoly implications. To do so, it looks at the slight variations among the advocates on the theme of what the limiting principle should be.

III. A RANGE OF LIMITING PRINCIPLES

This Section explores some of the proposed limiting principles in the various briefs. I briefly review six of the forty-four rules proposed by amici: those of the states, NetChoice, Public Knowledge, the United States, the Knight Foundation, and the First Amendment Scholars.

Several states, led by New York, filed a brief in support of neither party. They pointed out that "many . . . regulations have little, if any, effect on speech."[56] They asserted that "in assessing regulations of social media platforms, the Court must consider each challenged provision individually. Where a provision applies only to non-expressive conduct or otherwise has little or no effect on speech, the First Amendment does not limit States' authority to regulate."[57] In other words, neutral regulations with incidental impacts on speech are not subject to strict scrutiny.

22-277, NetChoice, LLC v. Paxton, No. 22-555 (Dec. 7, 2023) [hereinafter Brief of the Knight First Amendment Institute].

52. *See, e.g.*, Brief of First Amendment and Internet Law Scholars as Amici Curiae in Support of Respondents in No. 22-277 and Petitioners in No. 22-555 at 25–26, Moody v. NetChoice, LLC, No. 22-277, NetChoice, LLC v. Paxton, No. 22-555 (Dec. 6, 2023) [hereinafter Brief of First Amendment and Internet Law Scholars].

53. Brief of Law and History Scholars, *supra* note 16, at 4–7.

54. 418 U.S. 241, 244 (1974).

55. Act of June 16, 1971, ch. 71-136, sec. 59, § 104.38, 1971 Fla. Laws 573, *invalidated by* Miami Herald Publ'g Co. v. Tornillo, 418 U.S. 241 (1974).

56. Brief for States of New York et al. as Amici Curiae in Support of Neither Party at 4, Moody v. NetChoice, No. 22-277, NetChoice v. Paxton, No. 22-555 (Dec. 7, 2023) [hereinafter Brief for States of New York et al.].

57. *Id.* at 20.

Effectively, they supported the principle argued by Texas: rational basis review should be presumed when it comes to neutral regulation.[58]

Texas argued that "the First Amendment 'does not prevent restrictions directed at commerce or conduct from imposing incidental burdens on speech.'"[59] Nonetheless, the states chose to file on behalf of neither party. While the brief for New York et al. did not directly address this issue,[60] there are ways in which the Texas law could be struck down, or cabined, while preserving this general principle. The Court could, for instance, find the exceptions to the Texas Law unconstitutionally vague, or that they unconstitutionally target particular viewpoints for differential treatment. The Court could clearly signal openness to as-applied challenges, providing a roadmap for any enforcement action that appeared to be on viewpoint lines. Or the Court could use the logic of constitutional avoidance to interpret the statute in a narrow way.

On the other hand, NetChoice unsurprisingly proposed the most expansive rule, claiming that any regulation that implicates its content-moderation decisions must be subject to the most stringent First Amendment scrutiny.[61] The implication is that regulation that implicates content moderation is unconstitutional per se. NetChoice is also involved in litigation and lobbying around the country, attempting to block Child Social Media laws that regulate defective social media design.[62] So NetChoice's proposed rule would be helpful for those efforts, not just this case.

The amici in support of NetChoice ranged in how they expressed limiting principals. The most expansive was that of the Cato Institute, which argued that *PruneYard Shopping Center v. Robins* should be overturned.[63] Cato recognized the tension between *PruneYard* and striking down state regulation of open commercial fora, and encouraged that it be resolved in favor of First Amendment expansion.[64]

Public Knowledge's amici argued that the State may establish content-neutral *economic* regulations of social media platforms. Its analysis turned on whether the platform is a neutral transmission service or a service that engages in expressive conduct.[65] As Public Knowledge argued, "Where editorial discretion is central to the service, this Court has recognized that government cannot mandate common carriage."[66] Therefore, the Public Knowledge test is ultimately premised on a common carriage test, and the State must effectively prove common carriage prior to passing nondiscrimination laws.

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58. Brief for Respondent at 45, NetChoice v. Paxton, No. 22-555 (Jan. 16, 2024).

59. *Id.* (quoting Sorrell v. IMS Health Inc., 564 U.S. 552, 567 (2011)).

60. *See* Brief for States of New York et al., *supra* note 56.

61. *See* Brief for Petitioners at 46, NetChoice v. Paxton No. 22-555 (Nov. 30, 2023).

62. Natasha Singer, *Silicon Valley Battles States over New Online Safety Laws for Children*, N.Y. TIMES (Feb. 1, 2024), https://www.nytimes.com/2024/01/31/technology/social-media-free-speech-netchoice.html [https://perma.cc/EMF7-H5J5].

63. 447 U.S. 74 (1980); Brief of the Cato Institute as Amicus Curiae in Support of Respondents in 22-277 and in Support of Petitioners in 22-555 at 19–25, Moody v. NetChoice, LLC, No. 22-277, NetChoice, LLC v. Paxton, No. 22-555 (Dec. 7, 2023) [hereinafter Brief of the Cato Institute].

64. Brief of the Cato Institute, *supra* note 63, at 23–25.

65. Brief of Public Knowledge, *supra* note 16, at 7–8.

66. *Id.* at 8 (citing FCC v. League of Women Voters of Cal., 468 U.S. 364, 379 (1984)).

The United States argued on behalf of NetChoice that "[s]ocial-media companies are engaged in expressive activity when they decide which third-party content to display to their users and how to display it."[67] The United States further asserted: "This Court has long recognized that presenting a curated compilation of third-party speech is itself a form of speech."[68] Thus, the curated compilation of third-party speech is protected and must withstand strict scrutiny. Like Public Knowledge, the United States focused a great deal on common carriage questions, arguing that unlike common carriers, "the platforms are not merely conduits transmitting speech from one person to another. Instead, they are media companies presenting their own expressive offerings."[69] According to the United States, therefore, they should be treated like media companies.[70] As such, they should be

> subject to the antitrust laws and a wide range of other general regulations targeting conduct rather than speech. And even regulations targeting the platforms' expressive activities could be consistent with the First Amendment if they are content-neutral and do not burden substantially more speech than necessary to further legitimate government interests.[71]

However, the United States argued that "because the only interest the States have asserted here is a bare desire to change the way private social media platforms are exercising their editorial discretion, the Court need not consider how the First Amendment might apply to different regulations justified by different interests."[72] Therefore, "[a] government requirement that a platform include or promote content that it wishes to exclude or minimize implicates the First Amendment because it alters the expressive compilations the platform presents to its users."[73]

The United States's argument and proposed rule were complicated and appeared to be bound up, to some extent, with a test of the government's purpose—if the purpose is to regulate and constrain speech, and there is content moderation, then strict scrutiny applies.[74] While it stated that the First Amendment "poses no obstacle to data-privacy, consumer-protection, and other laws that regulate the platforms' nonexpressive activities," it did not clarify how the Court should address data privacy rules that constrain content moderation, or consumer protection laws that do the same.[75]

The Knight First Amendment Institute argued that social media platforms' content moderation decisions are protected by the First Amendment because they reflect the exercise of editorial judgment.[76] It argued that "the relevant level of scrutiny will turn on the nature of the regulation, with content-neutral regulations being subject to

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67. Brief for the United States as Amicus Curiae in Support of Respondents in No. 22-277 and Petitioners in No. 22-555 at 10, Moody v. NetChoice, No. 22-277, NetChoice v. Paxton, No. 22-555 (Dec. 7, 2023) [hereinafter Brief for the United States].

68. *Id.*

69. *Id.* at 10–11.

70. *Id.* at 11.

71. *Id.*

72. *Id.* at 12.

73. *Id.* at 19.

74. *See id.* 26–27.

75. *Id.* at 26.

76. Brief of the Knight First Amendment Institute, *supra* note 51, at 7–9.

intermediate scrutiny and content-based ones being subject to strict scrutiny."[77] It relied heavily on the concept of "editorial judgment" and *Tornillo*.[78] Its core point was that any regulation that directly constrains the ability of platforms to organize content should be subject to strict scrutiny, and may only be permissible if it withstands scrutiny.[79] Knight contended that strict scrutiny should apply when regulations restrict editorial judgment, and it defined editorial judgment in this way:

> When social media companies specify and enforce community standards, they make decisions roughly analogous to the ones this Court held to be protected in *Tornillo*, *Pacific Gas*, *Turner*, and *Hurley*. They decide what categories of content will appear on their platforms and what categories will not. Their decisions reflect judgments about the relative value of those categories of content. And collectively, these decisions determine the expressive character of the product they provide to their users. In *Tornillo*, the Court observed that "[t]he choice of material to go into a newspaper" is at the core of editorial judgment. Here, too, decisions about what content to include or exclude are properly characterized as editorial in nature.[80]

The implications of this reading are that whenever a company engages in decisions about categories of content, it cannot be limited in such decisions unless the limitation is justified by a compelling interest and narrowly tailored ("strict in theory, fatal in fact").[81]

Finally, the First Amendment Scholars brief argued that *users* have a First Amendment right to have social media platforms engage in content moderation.[82] They saw social media companies as effectively serving users' interests and protecting them from speech they do not want to hear.[83] The scholars' argued that the laws impermissibly burden speech by forcing users to listen to unwanted speech.[84] The limiting principle in this brief is not clear, but inasmuch as it was premised on a vision of social media platforms functioning as agents of users, the rule coming out of the brief would almost never permit the State to engage in regulation, because regulations predicated on content infringe on the freedom of users to listen. The Scholars' arguments built on *Citizens United v. FEC*,[85] and the long line of cases since 1978 finding that while corporations do not have speech rights, listeners to corporate speech do.[86] The amici argued that the laws burden users by swamping the platforms with content they do not want.[87]

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77. *Id.* at 3.

78. *Id.* at 7–11.

79. *See id.* at 12–14.

80. *Id.* at 10 (alteration in original) (citation omitted) (quoting Miami Herald Publ'g Co. v. Tornillo, 418 U.S. 241, 258 (1974)).

81. *See* Fullilove v. Klutznick, 448 U.S. 448, 519 (1980) (Marshall, J., concurring).

82. Brief of First Amendment and Internet Law Scholars, *supra* note 52, at 27.

83. *Id.*

84. *Id.* at 11.

85. 558 U.S. 310 (2010).

86. *See* Brief of First Amendment and Internet Law Scholars, *supra* note 52, at 25–26 (collecting cases).

87. *Id.* at 27.

IV. LIMITING PRINCIPLES AND POSSIBLE FEDERAL ANTITRUST LAWS

In recent years, there has been growing cross-ideological recognition that extreme market concentration poses an ongoing democratic and economic threat to the United States.[88] Having been allowed to acquire hundreds of companies during decades of lax antitrust enforcement, big tech companies have become choke points, or gatekeepers, with the ability to manipulate and control markets.[89] They shut out or steal from competitors and extract excessive benefits from their counterparties because of their central role.[90]

As the multiyear investigation by the House's subcommittee on antitrust found, self-preferencing and discrimination undermines competition, squashes innovation, shuts out smaller competitors from opportunity, and closes down the choices facing consumers.[91] Self-preferencing and discrimination also lead to a private realm of government, where the big tech companies govern. Several bills have come out of that investigation—new laws grounded in a premise of economic fairness: gatekeepers online should not be able to use their chokepoint power to self-preference over competitors or discriminate among businesses that rely on their platform.

A brief discussion of all of these proposals shows how the proposed tests, except that of the States, would undermine these efforts.

A. The Journalism Competition and Preservation Act

The Journalism Competition and Preservation Act (JCPA), introduced by Senator Amy Klobuchar, a Minnesota Democrat, is a recent bill with bipartisan support designed to give local news organizations the ability to negotiate with big tech companies siphoning off local news profits by exploiting their chokepoint monopoly.[92] Among other things, the law would forbid companies from discriminating in negotiations based on news organization size or the views expressed in their news content.[93]

If the NetChoice, Public Knowledge, United States, or Knight Foundation rule[94] were adopted, the JCPA's constitutionality could be thrown into question, because tech

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88. *See* BARRY C. LYNN, CORNERED: THE NEW MONOPOLY CAPITALISM AND THE ECONOMICS OF DESTRUCTION 243–44 (2010); TIM WU, THE CURSE OF BIGNESS: ANTITRUST IN THE NEW GILDED AGE 128–37 (2018); Kara Frederick, *Combating Big Tech's Totalitarianism: A Road Map*, HERITAGE FOUND. (Feb. 7, 2022), https://www.heritage.org/technology/report/combating-big-techs-totalitarianism-road-map [https://perma.cc/MQ2W-R9HV].

89. *See* Dina Srinivasan, *Why Google Dominates Advertising Markets: Competition Policy Should Lean on the Principles of Financial Market Regulation*, 24 STAN. TECH. L. REV. 55, 107–44 (2020); Shili Shao, Note, *Antitrust in the Consumer Platform Economy: How Apple Has Abused Its Mobile Platform Dominance*, 36 BERKELEY TECH. L.J. 353, 385–88 (2021).

90. *See* Jon Porter, *Developer Suing Apple for Stealing Idea, Calls on Others To Join the Fight*, THE VERGE (Feb. 5, 2022, 10:59 AM), https://www.theverge.com/2020/2/5/21124116/apple-developers-sherlocked-blix-bluemail-anonymous-email-feature [https://perma.cc/VMA6-3P6N].

91. *See generally* JERROLD NADLER & DAVID N. CICILLINE, INVESTIGATION OF COMPETITION IN DIGITAL MARKETS, H.R. DOC. NO. 117-8, 34–45, 72–73 (2022).

92. S. 673, 117th Cong. (2022).

93. *Id.* § 3.

94. See *supra* Section III for a discussion of the Amici briefs.

companies would be able to say that banning, for example, Fox News, while elevating NPR, was the exercise of editorial judgment and could not be constrained.

While the JCPA may seem like one example, it is almost a direct mirror of the law in the *Munn* case, because it limits discrimination by a central chokepoint monopolist. It is both a significant law and represents similar significant laws, and a ruling that threatened it would also threaten the potential for future laws designed to constrain monopoly power.

B. The American Innovation and Choice Online Act

Like the Texas and Florida laws, another bill proposed by Senator Klobuchar also limits discrimination by technology companies. The American Innovation and Choice Online Act (AICOA) would apply to certain large online platforms.[95] If it became law, the AICOA would regulate the major business lines of the largest online platforms, those that have "record net annual sales or market capitalization of more than $550 billion" and either "more than 50 million monthly active U.S. users[,] 1 billion worldwide users, [or] more than 100,000 active U.S. business users."[96] As of the writing of this Essay, this covers Amazon, Apple, Google, Facebook, Microsoft, and TikTok. The AICOA would also apply to platforms that gain similar market power. It has broad bipartisan support in Congress.[97] The Biden administration has also signaled its support for the bill, and it has been endorsed by the Department of Justice.[98]

The AICOA would prohibit ten different kinds of business activities, including self-preferencing in a way that harms competition;[99] limiting the ability of platform users to compete;[100] and most importantly, "discriminating in the application of their terms of service among similarly situated business users in a manner that would materially harm competition."[101]

If the *NetChoice* case is decided in favor of the tech companies, they could use the holding to challenge the constitutionality of the AICOA's nondiscrimination provision, arguing that discrimination in the application of their terms of service is a First Amendment protected activity, regardless of the harm to competition. Such a decision would be destructive to competition—tech giants would be emboldened to engage in more aggressive forms of discrimination and self-preferencing, knowing that they have been granted a First Amendment shield against government intervention with their "editorial judgment." Smaller competitors would be even further disadvantaged from gaining a foothold in overlapping markets with large technology platforms that engage in self-preferencing, potentially resulting in even further market concentration or reduced innovation.

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95. S. 2992, 117th Cong. (2022).

96. Adam Conner & Erin Simpson, *Evaluating 2 Tech Antitrust Bills To Restore Competition Online*, CTR. FOR AM. PROGRESS (June 2, 2022), https://www.americanprogress.org/article/evaluating-2-tech-antitrust-bills-to-restore-competition-online/ [https://perma.cc/7HHN-6PWJ]; *see also* S. 2992 § 2(a)(5).

97. *See* Conner & Simpson, *supra* note 96.

98. *Id.*

99. S. 2992 § 3(a)(1).

100. *Id.* § 3(a)(2).

101. Brief of Law and History Scholars, *supra* note 16, at 24; *see also* S. 2992 § 3(a)(3).

C. The Open App Markets Act

The Open App Markets Act (OAMA) is designed to ban app store operators from anticompetitive abuse of their platforms.[102] Like the AICOA, its goal is to break the big tech stranglehold on competition.[103] Under the OAMA, app stores with more than fifty million U.S. users would be prohibited from discrimination against third-party app developers operating on their platforms.[104] The app stores would be prohibited from actions that foreclose competition among apps and obstruct consumer access to apps.[105] In particular, the OAMA would require app stores to create alternate payment options and ban discriminatory pricing.[106] It would have a significant impact on the "international mobile phone duopoly—Apple's App Store and Google's Play store," as well as Microsoft's Windows App Store.[107]

As with the prior legislation, any of the proposed rules—except that of the states—would threaten the OAMA, because all of them would classify nondiscrimination as interfering with editorial discretion.

D. Packer and Stockyards Rulemaking

Federal rulemaking related to the Packer and Stockyards Act (PSA)[108] or the Federal Trade Commission Act (FTCA)[109] also includes a nondiscrimination component: the PSA requires nondiscrimination and the FTCA bans unfair business practices, which can include unfair discrimination on noncommercial bases.

While this is a rule, instead of a law, the same logic of the prior laws applies—a NetChoice win could provide a hook for big meatpackers, for example, to challenge the nondiscrimination provisions of the PSA.[110]

E. Social Media

A rule based on "editorial discretion" or "speech rights of hearers" would have a direct impact on the multiple efforts to limit the ability of big tech companies to exploit and addict children on social media.[111] New York, for instance, has proposed a law that would prohibit social media companies from using personally identifiable information

102. S. 2710, 117th Cong. (2022).

103. Press Release, Sens. Richard Blumenthal, Marsha Blackburn & Amy Klobuchar, Blumenthal, Blackburn & Klobuchar Introduce Bipartisan Antitrust Legislation to Promote App Store Competition (Aug. 11, 2021), https://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-blackburn-and-klobuchar-introduce-bipartisan-antitrust-legislation-to-promote-app-store-competition [https://perma.cc/DAS3-YRV8] ("This legislation will tear down coercive anticompetitive walls in the app economy, giving consumers more choices and smaller startup tech companies a fighting chance[.]" (quoting Sen. Richard Blumenthal)).

104. S. 2710 §§ 2, 3(a); *see also* Conner & Simpson, *supra* note 96.

105. S. 2710 § 3(a); Conner & Simpson, *supra* note 96.

106. S. 2710 § 3(a).

107. Conner & Simpson, *supra* note 96; S. 2710 § 3(a).

108. 7 U.S.C. §§ 181–229c.

109. 15 U.S.C. §§ 41–58.

110. *See* 9 C.F.R. §§ 201.300–.319 (2024).

111. U.S. SURGEON GEN., ADVISORY: SOCIAL MEDIA AND YOUTH MENTAL HEALTH 15–16 (2023), https://www.hhs.gov/sites/default/files/sg-youth-mental-health-social-media-advisory.pdf [https://perma.cc/5BVW-A5TW].

to target content to children without parental consent.[112] Additionally, the Kids Online Safety Act of 2022 sponsored by Senator Richard Blumenthal, a Connecticut Democrat, and others, would require social media companies to allow users to "opt out . . . of algorithmic recommendation systems" that use a minor's personal data.[113] In other words, both laws have a nondiscrimination provision.

Additionally, several states are considering bans on push notifications.[114] If any of the proposed rules were adopted, NetChoice could argue that these provisions should be subject to strict scrutiny, because they would constrain the ways social media companies can make choices about categorization. Essential state and federal regulation needed to address a mental health crisis could be significantly stymied or slowed.

F. Labor Protections on Viewpoint

Uber threatens speech in the same way as Tyson and other companies that built chokepoint monopoly power during the Chicago School years of antitrust policy.[115] Companies like Uber and Lyft have nearly unlimited surveillance capacity and the power to shut off or demote drivers when they engage in dissent. The gig economy, like the contract farming economy, encourages these companies to exploit their power as a central intermediary and use it to intimidate dissidents. When a distributor retaliates against a farmer because she joins an association, existing law should—but does not—protect that farmer.[116] New laws and rules are needed to prohibit companies holding chokepoint power from chilling democratic speech. For instance, existing labor laws should be expanded to forbid viewpoint-based retaliation, either through federal rulemaking or through state or federal statutes.[117]

These laws, too, could arguably be subject to strict scrutiny under the logic of any of the amici other than that of the states.

G. Future Utility Laws

Skype uses AI to censor content on its phone calls, making a name for itself as a safe phone service for children. Skype, therefore, is acting as something of a hybrid between a traditional phone service and a social media company. Skype enables both one-to-one and one-to-many calls. It would seem natural and obvious, before *NetChoice*, to think of Skype as a Voice over Internet Protocol provider and expect that

112. S.B. 7694, 2023 Leg., Reg. Sess. (N.Y. 2023), https://www.nysenate.gov/legislation/bills/2023/S7694 [https://perma.cc/7YPF-RMCV].

113. S. 3663, 117th Cong. § 4(a)(1)(D) (2022).

114. *See* Ruth Reader, *States Get Serious About Limiting Kids' Social Media Exposure*, POLITICO (Jan. 13, 2024, 7:00 AM EST), https://www.politico.com/news/2024/01/13/kids-online-states-social-media-00135390 [https://perma.cc/BB7R-CKY9]; *Social Media and Children 2023 Legislation*, NAT'L CONF. OF STATE LEGISLATURES, https://www.ncsl.org/technology-and-communication/social-media-and-children-2023-legislation [https://perma.cc/W2GC-P7D8] (last updated Jan. 26, 2024).

115. *See generally* Teachout, *supra* note 10.

116. *See* Spencer James Parts, Comment, *Tyson and Leviathan: USDA Rulemaking and the PSA Harm to Competition Requirement*, 1.1 U. CHI. BUS. L. REV. 591, 593 & n.8, 611 & n.144 (2022).

117. *See generally* Dubal, *supra* note 10.

federal utility regulation would cover Voice over Internet Protocol services, just as it covers phone services.

However, according to the logic of the amici,[118] such regulation would be illegitimate—because Skype engages in "content moderation" when it chooses to censor certain words, a nondiscrimination rule applied to Skype would be illegal. The Skype example, in fact, highlights the fundamental circularity of the NetChoice argument. Nondiscrimination rules are only necessary when discrimination is happening. In the language of NetChoice, we need constraints on content moderation only when content moderation is happening.[119] The nondiscrimination rules in *Munn* were required not *despite* "moderation" choices by the grain elevators, but *because of* them. The nondiscrimination rules in the various communications acts over the twentieth century were needed because of the risk of content moderation abuse.

This Essay is not designed as a roadmap for future deregulatory challenges, but as a warning about the vast unimagined consequences of a rule grounded in a version of "editorial discretion." None of the cases described above would be a slam dunk, and there would be ample room to make exceptions. A broad ruling for NetChoice could certainly tie up courts in litigation, and could succeed.

CONCLUSION

The *NetChoice* case could end up being a sleeper deregulatory bomb. It has the power to stop the use of democratic authority to protect against dangerous new tools and concentrations of power, just at the moment that regulation is beginning. Whatever you think of Florida Governor DeSantis or Texas Attorney General Paxton, the laws they have promoted are nondiscrimination laws, not laws that impose any particular viewpoint on companies. At heart, the fear of nondiscrimination is that it will enable a profusion of toxic websites, full of dangerous content, amplified by hate- and heat-seeking algorithms. This author shares that fear. However, that is a policy fear, not a First Amendment fear, and if the Supreme Court adopts the First Amendment shield against regulation that is advocated, the public will be barred from experimenting with key traditional antimonopoly tools, just at the moment when they are most needed.

118. See *supra* notes 76–87 and accompanying text for a discussion of the amicus brief of the Knight First Amendment Institute.

119. Brief for Petitioners, *supra* note 61, at 46.

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ARTICLE

THE HORIZONTAL MERGER EFFICIENCY FALLACY

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The Department of Justice and Federal Trade Commission Merger Guidelines (the "Merger Guidelines"), including the latest proposed revision in 2023 (the "New Merger Guidelines"), have continued to perpetrate what we call in this Article the horizontal merger efficiency fallacy. The fallacy arises because in the Guidelines the term "efficiencies" has become unmoored from its foundations in economic theory and has been reduced to the business school construct of cost savings. We show that cost savings can only be considered universally socially beneficial by acceptance of what is termed "the consumer welfare standard" (antitrust) or "the surplus theory of welfare" (economics), a theory that has been discredited and abandoned by welfare economists. In economic theory, efficiency means Pareto efficiency. We explore the various attempts to tether the cost savings definition of efficiency to Pareto efficiency and explain why these attempts have failed. We conclude that there is no sound way to theoretically reconcile cost savings with the economic meaning of efficiencies. We then move beyond the efficiency fallacy and show how modern welfare economics can be used to integrate congressional antitrust goals into the New Merger Guidelines. This requires abandoning the unsupported "standard deduction" for efficiencies and replacing it with an evidence-based assessment of how a specific merger under review potentially impacts congressional antitrust goals. This change renders the present efficiency rebuttal section of the New Merger Guidelines superfluous, and we provide specific reasons why this section as currently drafted is flawed and should be jettisoned.

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INTRODUCTION

The debate concerning the proper role of "efficiencies" in antitrust merger analysis has spanned many decades. Ever since Oliver Williamson's 1968 seminal paper advocating efficiencies as a merger defense,[1] antitrust experts have grappled with how the antitrust agencies and the courts should integrate information about efficiencies into antitrust merger analysis. We argue that this debate was ill-conceived from its inception.

The problem is that there is no commonly accepted meaning of "efficiency." Economists have a precise technical definition, while businesses and the general public do not. Businesses view efficiencies ("synergies") as any cost savings to the business. But nothing ensures that these cost savings increase societal welfare. Indeed, such cost savings could arise from reductions in the workforce or externalization of costs—for example, pollution that results from relaxed regulation and creates a net detriment to welfare.

In contrast, economics views efficiencies globally. As an example, cost savings to a business that results from a decrease in labor costs may have a detrimental impact on the economy as a whole due to the reduced purchasing power of the business's workers. This Article maintains that by permitting business definitions of "efficiency" to leak over into the antitrust lexicon, antitrust scholars have done a great disservice. Antitrust analysis purports to be informed by economic analysis. Therefore, it is the economic efficiencies that are relevant, rather than the provincial outlook of big business. This disjunction has led to misuse and abuse of the goals of antitrust law generally, and to misapplication of notions of efficiency more specifically, at the expense of the well-being of the overall economy.

This Article details, in eight parts, the disjunction between antitrust notions of efficiency and economic notions of efficiency and the effects of such disjunction.

Section I sets the stage, describing how "efficiency" became coextensive with "cost savings" in antitrust.

1. *See generally* Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968).

Section II explains how cost savings are related to the surplus theory of welfare and why the surplus theory of welfare is untenable and has been renounced by modern welfare economists. What industrial organization economists and antitrust lawyers mean when they assert that cost savings are "efficiencies" is that those cost savings can increase welfare under the specific welfare approach that most industrial organization economists have adopted. However, that approach has been soundly rejected by welfare economists. Under modern antitrust law's ill-conceived approach, "efficiency" is being used to denote an idiosyncratic notion of optimal welfare, not Pareto efficiency.

Section III explains that efficiency in economics means Pareto efficiency. But that concept has limited utility in crafting antitrust policy and, therefore, is not an effective tool. Few policy decisions can be made in which there are some winners and no losers; yet those are the only policy decisions that the Pareto criterion can address. Antitrust disputes, like all litigation, have winners and losers. Nonetheless, endorsing outcomes with no losers is a type of unanimous consent that has ethical attractiveness. There is a basic equal respect for all individuals, because no one is allowed to be harmed. This has led some economists to attempt (albeit under assumptions which are unrealistic in our view) to draw a connection between Pareto efficiency, the surplus theory of welfare, and cost savings.

Section IV details why these attempts to link cost savings with Pareto efficiency have failed. This Article explains how the surplus theory of welfare and Pareto efficiency are economically related, uncovering the outlandish assumptions that are required to link the two theories. Proponents of tethering the surplus theory of welfare to Pareto efficiency either suppress or ignore these assumptions. This Article maintains that such deception is detrimental to honest debate about antitrust policy.

Section V addresses the fact that, in the extensive law and economics literature, "efficiencies" mean Kaldor-Hicks efficiency.[2] This definition is not the economic definition, but it is also not cost savings as used in antitrust. Elsewhere, drawing on the work of many prominent welfare economists, we have shown that applying the Kaldor-Hicks efficiency approach to evaluate antitrust policy is inconsistent as well as economically and ethically bankrupt.[3] Here, this Article only points out the inconsistency in the economic treatment of efficiency in antitrust and in other areas of

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2. In 1939, Lord Nicholas Kaldor suggested an approach which he thought would overcome the limitations of the Pareto principle by not requiring unanimous support for a policy proposal. Lord Kaldor suggested that a policy should be adopted if the policy's beneficiaries could, in principle, enable people to be better off than they were before and compensate the people who lose because of the policy. But the compensation need not, in actuality, be made. This is referred to as a "potential Pareto" criterion ("PP") or as "cost-benefit analysis." *See generally* Nicholas Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 ECON. J. 549 (1939). The other "potential Pareto" criterion, which comes from Sir John Richard Hicks, is that a policy should be not adopted if the beneficiaries of the non-adoption (who are the losers of the original policy) could, in principle, compensate the losers of the non-adoption (who are the beneficiaries of the original policy), and still be better off than they would be if the policy were adopted. *See* J. R. Hicks, *Consumers' Surplus and Index-Numbers*, 9 REV. ECON. STUD. 126 (1942). "Kaldor-Hicks Efficiency" means Kaldor efficiency in most law and economics literature because authors do not distinguish between the Kaldor and Hicks definitions of efficiency. *See* Mark Glick, Gabriel A. Lozada & Darren Bush, *Why Economists Should Support Populist Antitrust Goals*, 2023 UTAH L. REV. 769, 799 n.110.

3. *See generally* Glick et al., *supra* note 2.

economic analysis of law, such as contracts and property law. Economists who study areas of the law other than antitrust do not conflate efficiencies with cost savings, so why do we try to do so in antitrust? This Article argues that we should not.

Section VI describes how modern welfare economists approach measurement of human welfare. This approach lies in stark contrast to the surplus theory of welfare. The modern approach is based on a social welfare function that is informed by survey data, psychological and experimental studies, philosophical intuition and argument, and other sources. This Article compares the various goals for antitrust enforcement suggested in opposition to the Chicago School Consumer Welfare Standard with these welfare findings. We find that there is strong congruence between those goals and the results of the major research in welfare economics.

Section VII argues that effective policymaking requires identifying the welfare-affecting policy factors that should be taken into account. This Article maintains that, in the case of antitrust, the identification process should be guided by the legislative priorities that motivated the antitrust laws in the first place. Congress made clear that its concern with curbing concentration through the antitrust laws was necessary to address threats to democracy, threats to small businesses, and objectionable income transfers, as well as price increases and output decreases. Accordingly, cost savings are relevant only when they favorably influence these congressional priorities—but, in practice, they rarely do. This justifies an entirely different focus.

Section VII develops a way to integrate congressional values into merger analysis. We contend that the Merger Guidelines' assumption of a "standard deduction" for the efficiencies undergirding the concentration levels that trigger an antitrust challenge should be replaced with an evidence-based welfare analysis. Under this approach, the concentration screening levels are calibrated by the likelihood that the specific firms and markets at issue could impact congressional antitrust goals.

Finally, Section VIII explains why the present efficiency rebuttal section in the New Merger Guidelines should be abandoned.

I. How Antitrust Merger "Efficiencies" Became Code for "Cost Savings"

So how is it that antitrust economists and attorneys have come to define "merger efficiencies" as cost savings resulting from combining two or more companies? As we shall see, part of the problem was the initial failure to define "efficiency." This definitional vacuum provided a void that business interests were more than happy to fill, permitting an economic term to be replaced by a business school definition influenced by firm-centric values.

The modern literature on merger efficiencies—and the initial confusion—begins with Oliver Williamson's 1968 paper, *Economies as an Antitrust Defense*.[4] Actually, Williamson never explicitly defined "efficiency," but referred to the concepts of "economies" and "scale economies."[5] In the analytical part of his paper, efficiencies

4. Williamson, *supra* note 1.
5. *See id.* at 18–19.

were explicitly modeled as reductions in average costs, and Williamson referred to these reductions as "cost reductions."[6]

Legal scholar Robert Bork borrowed from Williamson but had broader notions of efficiency in mind. Bork reproduced Williamson's diagram of a merger that both raises price and reduces costs, labeled it "efficiency" in his book *The Antitrust Paradox*, and repackaged the concept as the impact of a merger on "consumer welfare."[7] But Bork was explicit that efficiencies are *not* just cost savings: "[C]ost savings are but one element or form of increased efficiency."[8]

However, Bork neither elaborated nor explained what the other elements of efficiency were, in his view. Additionally, while he opposed an explicit efficiency defense for mergers, on the grounds that such an analysis was too complicated for the courtroom, he offered no elaboration on what those complications were.

The 1968 Merger Guidelines seemed to anticipate Williamson's cost definition of efficiencies as economies of scale, but also adopted a dose of Bork's skepticism. According to the 1968 Merger Guidelines, "[u]nless there are exceptional circumstances, the Department [of Justice] will not accept as a justification for an acquisition normally subject to challenge under its horizontal merger standards the claim that the merger will produce economies (i.e., improvements in efficiency) . . . ."[9] Thus, at least implicitly, the 1968 Merger Guidelines identified cost savings as efficiencies, but also reserved their consideration for "exceptional circumstances."

This initial definitional confusion was ripe for exploitation by those interested in restricting the reach of the antitrust laws. The neoliberal agenda and push for antitrust reform expanded the notion of increased defenses to antitrust enforcement, including in the realm of efficiencies. Timothy Muris's 1980 article, *The Efficiency Defense Under Section 7 of the Clayton Act*, advocated for an explicit efficiency merger defense.[10] He wrote that "the efficiency defense, as that term is used in this article, refers to a cost-decrease."[11] According to Muris, "[i]n merger litigation, an increase in efficiency should be defined as a decrease in costs."[12] In defining efficiencies broadly, Muris reaches beyond Williamson. For Muris, cost reductions are not limited to scale economies, but also include the reduction of transaction costs, the cost of financing, and improvements in management.[13]

6. *Id.* at 21–22, 21 fig.1.

7. ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 107 (Bork Publ'g 2021) (1978).

8. *Id.* at 109.

9. U.S. DEP'T OF JUST., 1968 MERGER GUIDELINES § 10 (1968) [hereinafter 1968 MERGER GUIDELINES], https://www.justice.gov/archives/atr/1968-merger-guidelines [https://perma.cc/D2EC-UKWZ].

10. Timothy J. Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 CASE W. RES. L. REV. 381, 383 (1980).

11. *Id.* at 385.

12. *Id.* at 417.

13. *Id.* at 418–19. In 1982, the DOJ issued new Merger Guidelines. The Merger Guidelines never define efficiencies, but they state that efficiencies can be a defense to a merger challenge. *See* U.S. DEP'T OF JUST., 1982 MERGER GUIDELINES § V, https://www.justice.gov/archives/atr/1982-merger-guidelines [https://perma.cc/8FHT-69YU].

Alan Fisher and Robert Lande joined the debate in 1983, offering a more skeptical assessment of efficiencies than Muris. They analyzed the role of efficiencies in merger legislation, the courts, and the agencies and concluded that an efficiency defense is neither workable nor desirable.[14] In a paper exceeding one hundred pages, Fisher and Lande paradoxically devoted only a single paragraph to defining efficiencies. They wrote that efficiencies are "economies of scale, resource allocation, technological complementarities, specialization in product line, reduction in transportation costs, and various kinds of transaction-cost economies . . . ."[15] All of these items can be understood as types of cost reductions.

A year after the Fisher and Lande article, the Department of Justice (DOJ) issued the 1984 Merger Guidelines. Section 3.5 of the new guidelines defined efficiencies as "economies of scale, better integration of production facilities, plant specialization, [and] lower transportation costs . . . [and asserted that it] may also consider claimed efficiencies resulting from reduction in general selling, administration, and overhead expenses . . . ."[16] Again, efficiencies were understood as cost reductions. The DOJ and the Federal Trade Commission (FTC) issued revised Merger Guidelines in 1992 that carried the same efficiency description as the 1984 Merger Guidelines.[17]

Gregory Werden's 1997 *Antitrust Magazine* article on merger efficiencies defined an efficiency resulting from a merger as "lower cost, higher quality, or greater facility for innovation."[18] Werden used the concept of asset utilization to classify efficiencies. By this, he meant how much an asset's value can be spread over output. Innovation occurs when greater use of an intangible asset occurs. "Making one merging firm's superior technology available to the other can lower the latter's cost or improve its quality."[19] Physical assets and human resources can also be used by the merging parties to lower costs. Werden thus understood merger efficiencies as cost-reducing or quality-increasing effects of the combination of firms. However, post-merger quality increases simply imply that the merger allowed the parties to reduce the cost of the quality increase. Indeed, it would be difficult to argue that a firm was totally incapable of a quality increase absent a merger. Thus, under Werden's construct, quality improvements are also a cost-savings concept.

In 1997, the DOJ and the FTC revised the Merger Guidelines with respect to efficiencies. In this updated version, efficiencies were defined as "better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given

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14. *See generally* Alan A. Fisher & Robert H. Lande, *Efficiency Considerations in Merger Enforcement*, 71 CALIF. L. REV. 1580 (1983).

15. *Id.* at 1599. Professor of Law Daniel Crane adopted this definition of efficiencies. *See* Daniel A. Crane, *Rethinking Merger Efficiencies*, 110 MICH. L. REV. 347, 355 (2011).

16. U.S. DEP'T OF JUST., 1984 MERGER GUIDELINES § 3.5 (1984) [hereinafter 1984 MERGER GUIDELINES], https://www.justice.gov/archives/atr/1984-merger-guidelines [https://perma.cc/63RU-E84X].

17. *Compare id.*, *with* U.S. DEP'T OF JUST. & FTC, 1992 HORIZONTAL MERGER GUIDELINES § 4 (1992) https://www.justice.gov/archives/atr/1992-merger-guidelines [https://perma.cc/478V-V3KC].

18. Gregory J. Werden, *An Economic Perspective on the Analysis of Merger Efficiencies*, ANTITRUST MAG., Summer 1997, at 12, 12.

19. *Id.*

quantity and quality than either firm could have achieved without the proposed transaction."[20] What remained unchanged was that efficiencies meant cost savings.

William Kolasky and Andrew Dick authored an extensive review of the debate around merger efficiencies in 2003.[21] In an Appendix titled *A Taxonomy of Efficiencies*, the authors classified efficiencies into four types: allocative, productive, dynamic, and transactional. At bottom, these categories are merely versions of cost savings. The authors used the term allocative efficiencies as coextensive with a situation where price equals marginal cost for a single firm.[22] Production efficiency is described as "economies of scale, economies of scope and synergies," which, again, is merely cost savings.[23] Dynamic efficiencies involve "innovation to lower costs and develop new and improved products."[24] However, a merger is not strictly necessary to develop a new or improved product. Accordingly, this is just shorthand for the argument that the merger is alleged to reduce the costs (in money and possibly time) to achieve these improvements. Similarly, transactional efficiencies result from mergers that reduce transaction costs, including the costs of using the market for transactions in the face of market failures that make contracting costly.[25]

In 2009, Malcolm Coate and Andrew Heimert reported on an internal study of merger efficiencies conducted at the FTC.[26] The authors defined twelve categories of efficiencies. Five categories involved reductions in fixed costs and five categories were defined as reductions in variable costs. The eleventh category was a reduction in transaction costs. A final category was reserved for claims that were difficult to classify due to lack of information from the merging parties. The study showed that both the understanding of efficiencies by the Bureau of Economics and the efficiencies claimed by merging parties were essentially limited to cost savings.

In a 2015 article, John Kwoka described the changing nature of efficiencies claimed by merging parties.[27] Kwoka identified three new types of efficiencies being asserted by merging parties: "dynamic considerations, quality benefits, and vertical

20. U.S. DEP'T OF JUST. & FTC, 1997 HORIZONTAL MERGER GUIDELINES § 4 (1997) [hereinafter 1997 HORIZONTAL MERGER GUIDELINES], https://www.justice.gov/archives/atr/1997-merger-guidelines [https://perma.cc/MAX3-4YUE]. The 2010 DOJ and FTC Horizontal Merger Guidelines track the efficiency definition in the 1997 Merger Guidelines. *See* U.S. DEP'T OF JUST. & FTC, 2010 HORIZONTAL MERGER GUIDELINES § 10 (2010) [hereinafter 2010 HORIZONTAL MERGER GUIDELINES], https://www.justice.gov/atr/horizontal-merger-guidelines-08192010 [https://perma.cc/NF75-C2XH].

21. *See generally* William J. Kolasky & Andrew R. Dick, *The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers*, 71 ANTITRUST L.J. 207 (2003).

22. Yet, the authors provided no examples of horizontal mergers that move price toward marginal cost. *See id.* at 243. Instead, they described vertical integration as eliminating the double marginalization problem. *Id.*

23. *Id.* at 244.

24. *Id.* at 247.

25. *Id.* at 249.

26. *See generally* MALCOLM B. COATE & ANDREW J. HEIMERT, FTC, ECONOMIC ISSUES: MERGER EFFICIENCIES AT THE FEDERAL TRADE COMMISSION 1997–2007 (2009); Malcolm B. Coate, *Efficiencies in Merger Analysis: An Institutionalist View*, 13 SUP. CT. ECON. REV. 189 (2005).

27. John Kwoka, *The Changing Nature of Efficiencies in Mergers and in Merger Analysis*, 60 ANTITRUST BULL. 231, 231 (2015).

economies."[28] Dynamic considerations involve "lowering of the total cost of achieving the same extent of technological output," or "more innovation output per dollar of input."[29] Quality improvements involve the transfer of best practices or benefits from integrating services.[30] Again, such quality improvements may not be merger-specific. Finally, vertical economies "derive from savings in information and transactions costs, from greater assurance of supply, from better coordination between stages of production, and from avoidance of double marginalization."[31]

The New Merger Guidelines begin with a recognition that under controlling Supreme Court precedent, the Clayton Act does not allow for an efficiency defense.[32] Instead, the New Merger Guidelines incorporate an efficiency rebuttal.[33] In essence, the New Merger Guidelines contemplate that if the merging parties can show the existence of verifiable and merger-specific cost savings that are passed on to consumers in lower prices, these price reductions can be factored into the analysis of the likely total anticompetitive effects from an undue increase in concentration post-merger.[34] Thus, it is clear that the New Merger Guidelines have adopted the cost savings definition of efficiencies.

In sum, the antitrust literature has been consistent regarding the meaning it assigns to "efficiencies." At every turn, law professors and economists, as well as the agencies' Merger Guidelines, define "efficiencies" in merger analysis as cost savings. But should they? We maintain, no. As we detail in subsequent sections, such an interpretation is unique to antitrust. Nowhere else in economics does "efficiency" mean "cost savings."[35] In economics, efficiency means Pareto efficiency.[36] Where "efficiency" does mean "cost savings" is in the language of business owners. Indeed, the only arguable economic justification for equating efficiency and cost savings is within the surplus theory of welfare, where such cost savings can increase a narrow definition of welfare.[37]

But antitrust law and policy's review and oversight of proposed mergers should be driven by economic, not business, analysis, and should incorporate the most up-to-date and generally accepted economic analysis. Accordingly, calling cost savings "efficiencies" is not only confusing, but also unsupportable. It distorts economic terminology in a way that favors business owners, to the detriment of society as a whole.

There is yet another implication to this semantic exercise, however. No clear discussion of issues is possible if language is distorted in this way. But correcting the

28. *Id.* at 236.

29. *Id.*

30. *Id.* at 238.

31. *Id.* at 242.

32. U.S. DEP'T OF JUST. & FTC, 2023 MERGER GUIDELINES 1–2 (2023) [hereinafter 2023 MERGER GUIDELINES], https://www.justice.gov/atr/2023-merger-guidelines [https://perma.cc/9ULE-K9ZC].

33. *See id.* §§ 1, 3 ("Section 3 identifies rebuttal evidence that the Agencies consider, and that merging parties can present, to rebut an inference of potential harm under these frameworks.").

34. *Id.* § 3.3.

35. *See infra* Section V.

36. *See infra* Section III.

37. *See infra* Section II.

semantics poses a conundrum, because we need to seriously engage with past authors who have accepted this confusing terminology. Accordingly, for clarity, when we mean "cost savings" we will call them "cost savings," not "efficiencies." When we mean "welfare improvements," we will use that term and not further confuse the word "efficiencies." When we use efficiency, it will mean what economists mean, Pareto efficiency, unless we enclose it in quotation marks for satirical purposes, as in the next section heading.

II. "EFFICIENCIES" IN THE ECONOMIC THEORY OF MARSHALL AND PIGOU: WHY COST SAVINGS ALONE ARE NOT NECESSARILY WELFARE-IMPROVING

A. *The Surplus Theory of Welfare*

The word "efficiency" has many meanings. In physics, it is a nonmonetary concept, the purpose of which is to describe the work performed per quantity of energy input. It is examined on a system basis.[38] But this definition is not identical to the way economists use the term.

In social sciences, "efficiency" has a strong positive connotation.[39] It appears to signify something socially beneficial: maximizing some "good," subject to constraints that are "bad." But when "efficiency" is used (or abused) as a synonym for cost savings, we may ask, what is so beneficial about cost savings? Why should society sacrifice the benefits of competition to achieve cost savings through mergers? The argument advanced by antitrust economists (which we use as coextensive with industrial organization economists who specialize in competition policy) is that cost savings increase welfare. But how do cost savings increase welfare? By "welfare," economists mean human well-being as experienced by the individuals themselves.[40] Accordingly, linking cost savings to welfare requires a theory of welfare. Historically, that theory is known as the surplus theory of welfare, and a version of the surplus theory of welfare was repackaged and popularized by Robert Bork, as the "consumer welfare" standard.[41]

British economists Alfred Marshall and Arthur Pigou were the first to introduce the surplus approach to welfare to English-speaking economists. In 1890—the same

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38. *See generally* PHILIP MIROWSKI, MORE HEAT THAN LIGHT: ECONOMICS AS SOCIAL PHYSICS, PHYSICS AS NATURE'S ECONOMICS (1989).

39. *See generally* Darren Bush, *Consumer Welfare Theory as an Ethical Consideration: An Essay on Hipsters, Invisible Feet, and the "Science" of Economics*, 63 ANTITRUST BULL. 509 (2018). A version of this article is also available online. *See* Darren Bush, *Antitrust Economics as Religion: Hipsters, Invisible Feet, and the 'Science' of Consumer Welfare Theory*, SSRN (Sept. 25, 2018), https://ssrn.com/abstract=4558404 [https://perma.cc/DQX2-M4E3]. Thomas J. Horton, *Restoring American Antitrust's Moral Arc*, 62 S.D. L. REV. 11 (2017); Maurice E. Stucke, *Reconsidering Antitrust's Goals*, 53 B.C. L. REV. 551 (2012); John J. Flynn & James F. Ponsoldt, *Legal Reasoning and the Jurisprudence of Vertical Restraints: The Limitations of Neoclassical Economic Analysis in the Resolution of Antitrust Disputes*, 62 N.Y.U. L. REV. 1125 (1987).

40. LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 16 (2002) ("The hallmark of welfare economics is that policies are assessed exclusively in terms of their effects on the well-being of individuals.").

41. *See generally* BORK, *supra* note 7, at 107–15. See Glick et al., *supra* note 2, at 775–76 for a discussion of Robert Bork's adoption of Marshall's theory of welfare.

year that Congress passed the Sherman Act[42]—Marshall introduced the concept of consumer surplus in the first edition of his *Principles of Economics*.[43] Marshall defined consumer surplus in the following passage: "The excess of price which [a consumer] would be willing to pay rather than go without the thing, over that which he actually does pay, is the economic measure of this surplus satisfaction. It may be called *consumer's surplus*."[44]

In other words, consumer surplus is the difference between the consumer demand curve and price—what a consumer is willing to pay compared to what she actually paid. Similarly, producer surplus is defined as the difference between the price the producer obtains for her product and the (variable) cost to produce that product. Thus, cost savings increase producer surplus and, if passed through to consumers in the form of lower prices, can potentially increase consumer surplus as well. This is the theoretical link between cost savings and welfare. But is the link more than theoretical?

Sociologist Elizabeth Popp Berman described how industrial organization economics used surplus theory to challenge the liberal New Deal and Great Society programs. In her view (and we concur), industrial organization economists' use of the word "efficiency" in place of welfare expansion was simply clever marketing:

> The systems analysts and [industrial organization] economists who brought the economic style to Washington typically saw it as neutral and technocratic. But its core values—particularly, its commitment to efficiency—led its advocates to distinctive types of policy solutions . . . . Great Society legislation was not grounded in the economic reasoning of efficiency and cost-effectiveness. Instead, it prioritized other types of arguments that Lyndon Johnson and a substantial fraction of Democrats found compelling, including those based on universalism, equality, and rights.[45]

The theory of welfare referred to by Professor Popp Berman, which we refer to as the output market surplus theory of welfare, is widely adopted by industrial organization economists, as evidenced by its universal endorsement by industrial organization textbooks.[46] Law professor and leading antitrust scholar Joe Brodley's

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42. 15 U.S.C. §§ 1–38.

43. *See generally* ALFRED MARSHALL, PRINCIPLES OF ECONOMICS (8th ed. 1920). Marshall's seminal work was first published in 1890 and ran to eight editions last published in 1920. John K. Whitaker, *Marshall, Alfred (1842-1924)*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS 8350, 8353–54 (John Eatwell, Murray Milgate & Peter Newman eds., 3d ed. 2018). An earlier description of the concept of consumer surplus was advanced by economist Jules Dupuit. *See generally* Jules Dupuit, *On the Measurement of the Utility of Public Works*, *in* 2 INTERNATIONAL ECONOMIC PAPERS 83, 83–110 (1952). Dupuit's article originally appeared in 8 ANNALES DES PONTS ET CHAUSSEES [ANNALS OF BRIDGES AND ROADS] 332–75 (2d ed. 1844).

44. MARSHALL, *supra* note 43, at 124.

45. ELIZABETH POPP BERMAN, THINKING LIKE AN ECONOMIST: HOW EFFICIENCY REPLACED EQUALITY IN U.S. PUBLIC POLICY 98 (2022). *See generally* BINYAMIN APPELBAUM, THE ECONOMISTS' HOUR: FALSE PROPHETS, FREE MARKETS, AND THE FRACTURE OF SOCIETY (2019).

46. LYNNE PEPALL, DAN RICHARDS & GEORGE NORMAN, CONTEMPORARY INDUSTRIAL ORGANIZATION: A QUANTITATIVE APPROACH 22–23 (2011); PAUL BELLEFLAMME & MARTIN PEITZ, INDUSTRIAL ORGANIZATION: MARKETS AND STRATEGIES 70–71 (2d ed. 2015); DON E. WALDMAN & ELIZABETH J. JENSEN, INDUSTRIAL ORGANIZATION THEORY AND PRACTICE 70–71 (4th ed. 2016); F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 27–28 (3d ed. 1990); ROGER D. BLAIR & DAVID L. KASERMAN, ANTITRUST ECONOMICS 22–24 (2d ed. 2008); DENNIS W.

1987 paper on merger efficiencies is emblematic of the incorporation of this theory into antitrust law. Brodley wrote that, "[a]s used by economists, economic efficiency refers to a decision or event that increases the total value of all economically measurable assets in the society or total social wealth."[47] Total value is the sum of consumer and producer surplus, plus the total goods and services produced at current prices.

Yet as we now explain, the surplus theory of welfare is seriously flawed, and cost savings alone do not correspond to improved human well-being.

B. *The Output Market Surplus Theory of Welfare Is Flawed and Has Been Abandoned by Welfare Economists*

There are several major flaws in the output market surplus theory of welfare that render it unreliable, and an inaccurate and biased measure of well-being. Three limitations were recognized by the founders of the theory, Marshall and Pigou, but then stripped from the theory when it was adopted by antitrust specialists. First, Marshall and Pigou included input markets, such as the labor market, and not just the output market. Second, surplus was recognized by Marshall and Pigou as only a part of welfare, not to be confused with a method to undergird economic policy. Third, both Marshall and Pigou understood that welfare is decidedly dependent on distribution. Later economists have pointed out numerous other logical inconsistencies in the theory that led to its abandonment by all but the industrial organization field (and economics textbooks).

1. Output Market Surplus Does Not Account for Labor Rents

Consumer surplus and producer surplus pertain to output markets. In input markets, the analogous concept is "economic rent," the difference between the price the input supplier obtains and the minimum price required to induce the input supplier to supply the input. Total surplus is the sum of consumer surplus, producer surplus, and economic rent. Pigou clearly considered economic rent as part of welfare. For example, he wrote: "The economic welfare of a community consists in the balance of satisfactions derived from the use of the national dividend over the dissatisfactions involved in the making of it."[48]

Yet, paradoxically, labor rents and other input-supplier rents are ignored by merger analyses of efficiencies.[49] This is a clear error. Every output has inputs, and

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CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 102–07 (2d ed. 1994); STEPHEN MARTIN, INDUSTRIAL ECONOMICS: ECONOMIC ANALYSIS AND PUBLIC POLICY 27–31 (2d ed. 1993); WILLIAM E. SHUGHART II, THE ORGANIZATION OF INDUSTRY 25–26 (1990); JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION 6–12 (1988).

47. Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020, 1025 (1987).

48. A.C. PIGOU, THE ECONOMICS OF WELFARE 85 (4th ed. 1932).

49. Ioana Marinescu & Herbert Hovenkamp, *Anticompetitive Mergers in Labor Markets*, 94 IND. L.J. 1031, 1032 (2019) ("To the best of our knowledge no court has ever condemned a merger because of its anticompetitive effects in labor markets."); ERIC A. POSNER, HOW ANTITRUST FAILED WORKERS 76 (2021) ("And, indeed, the FTC and DOJ have never blocked a merger based on labor market effects. This is a serious mistake, for which there is no justification."); Maurice E. Stucke, *Looking at the Monopsony in the Mirror*, 62 EMORY L.J. 1509, 1512 (2013) [hereinafter Stucke, *Looking at Monopsony*] ("Despite these concerns, the

studying input markets is no less important than studying output markets. Omitting economic rent from surplus calculations is a serious mistake unless input markets are unaffected by the output market—a dubious assumption at best. Moreover, employment and quality of work are key determinants of welfare, as we show in Section VI.

Therefore, Williamson's definition of welfare, the one adopted in merger analysis, only makes sense if output market events, such as a merger of firms that produce final goods (consumer goods), have no effect on input markets. In particular, Williamson's definition of welfare only applies if a merger has no impact on input prices. In an analysis that correctly encompasses all types of surplus instead of leaving rents out, cost savings that come from lower wages or unemployment are not efficiencies, they are simply transfers. To be welfare-enhancing, the cost savings must result despite input prices remaining unchanged, otherwise welfare gains in the output market would need to be offset against welfare losses in the input market. This leaves only two potential sources of cost savings resulting from a merger that are consistent with the Williamson model: a favorable shift of the production function (presumably due to technological change), or a change in output level to a level with lower average cost of production.

2. Economic Surplus Is Only a Part of Welfare

Both Marshall and Pigou understood that "not all desirable things are reckoned as wealth."[50] In other words, surplus does not measure total welfare. It only measures that part of human welfare related to goods and services traded in markets.[51] Marshall recognized that human quality of life can be impacted by many factors. He believed

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larger jurisdictions, to date, have challenged few mergers or conduct cases that target monopsony or buyer power."). A collection of recent sources on this topic can be found in Hiba Hafiz, *Interagency Merger Review in Labor Markets*, 95 CHI-KENT L. REV. 37, 38 n.1 (2020). The impact of monopsony power on minorities and women, who can be even more vulnerable to wage reductions, is discussed in Mark Stelzner & Kate Bahn, *Discrimination and Monopsony Power*, 49 REV. BLACK POL. ECON. 152, 160 (2022) ("Because of the socially constructed norm which places more household responsibilities on woman [sic] compared to men on average, women are more likely to supply their labor to a smaller geographical area. This gives the firms in that area more monopsony power over their female employees. Likewise, Black and Latino workers are less likely to respond to wage differences between jobs because of the potential monetary shocks that can befall a worker in the job transition process and the dramatically lower average and median household wealth of Black and Latino households compared with White counterparts. This allows firms to more intensely exercise their monopsony power over Black and Latino workers."); *see also* Aryeh Mellman, Note, *Measuring the Impact of Mergers on Labor Markets*, 53 COLUM. J.L. & SOC. PROBS. 1, 21 n.97 (2019) ("In an October 2018 hearing, the FTC Chairman stated that FTC staff 'has been specifically instructed to look at each merger for potential anticompetitive impacts on labor,' but acknowledged that his agency had never challenged a merger 'specifically over concerns related to labor market competition.'" (quoting *Oversight of the Enforcement of the Antitrust Laws: Hearing Before the Antitrust Subcomm. of the S. Comm. on the Judiciary*, 115th Cong. 31 (2018) (statement of Joseph Simons, FTC Chairman))).

50. Glick et al., *supra* note 2, at 777 (quoting MARSHALL, *supra* note 43, at 54).

51. *Id.*; *see also* MARSHALL, *supra* note 43, at 134 ("When we speak of the dependence of wellbeing on material wealth, we refer to the flow or stream of wellbeing as measured by flow or stream of incoming wealth and the consequent power of using and consuming it."); Robert Cooter & Peter Rappoport, *Were the Ordinalists Wrong About Welfare Economics?* 22 J. ECON. LIT. 507, 513 (1984) (arguing that Marshall and Pigou were part of the material welfare school that considered only economic welfare in markets and were displaced by the ordinalists that considered all sources of welfare).

that surplus in markets only pertained to a part of welfare, which he labeled "economic welfare."[52] Pigou explained that this part of total welfare cannot be separated "in any rigid way" from other parts.[53] Pigou reasoned that economic welfare was worthy of study only so long as policies that impact economic welfare do not diminish other elements of welfare.

Pigou acknowledged that he had no evidence to suggest that promotion of economic welfare impacted noneconomic welfare. However, since Pigou's time, significant experimental economic evidence, psychological studies, and historical case studies have shown that policies that have narrow economic motivations can crowd out other ethical and community motives.[54] As explained by economists Richard Layard and Jan-Emmanuel De Neve:

> In the eighteenth-century Anglo-Scottish Enlightenment, the central concept was that we judge a society by the happiness of the people. But unfortunately, there was at the time no method of measuring wellbeing. So, income became the measure of a successful society, and GDP per head became the goal. But things are different now. We are now able to measure wellbeing, and policy-makers around the world are turning towards measures of success that go "beyond GDP."[55]

Given the dramatic progress in the study of economics in general, it is remarkable that antitrust and industrial organization economists continue to focus on surplus-based notions of welfare. Rather than acknowledge and embrace this paradigm shift in economic thought and pedagogy, consumer welfare advocates have instead doubled down on their outdated theories or pivoted to an output-based approach that is still fundamentally tethered to surplus-based notions of welfare.[56]

3. Economic Surplus Ignores Distribution

Another defect recognized by Marshall and Pigou was their theory's ignorance of the effect distribution has on welfare. Mergers are analyzed in markets. Consumer and producer surplus are only useful concepts in antitrust if they can be extended from a single individual to markets. This extension poses major problems.

When economists observe a consumer's demand for a product or service, they measure the consumer's willingness to pay in dollars. They do not directly observe the welfare or utility obtained. Therefore, economists need to know, or assume they know, how much welfare is represented by a dollar. If this relationship is constant and the

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52. Marshall wrote that "not all desirable things are reckoned as wealth. The affection of friends, for instance, is an important element of wellbeing, but it is not reckoned as wealth, except by a poetic license." MARSHALL, supra note 43, at 54.

53. PIGOU, *supra* note 48, at 11; MAURICE DOBB, WELFARE ECONOMICS AND THE ECONOMICS OF SOCIALISM: TOWARDS A COMMONSENSE CRITIQUE 30 (1969).

54. Sam Bowles extensively reviewed this evidence. *See generally* SAMUEL BOWLES, THE MORAL ECONOMY: WHY GOOD INCENTIVES ARE NO SUBSTITUTE FOR GOOD CITIZENS (2016); DUNCAN FOLEY, ADAM'S FALLACY: A GUIDE TO ECONOMIC THEOLOGY (2006).

55. RICHARD LAYARD & JAN-EMMANUEL DE NEVE, WELLBEING SCIENCE AND POLICY 1 (2023).

56. *See generally* Darren Bush, *Antitrust Heretics and the Problem of One-Sided Bias: An Essay* (October 13, 2023), https://ssrn.com/abstract=4601891 [https://perma.cc/A9PQ-6R88] (describing attempts to rebrand, rename, and redefine consumer welfare).

same for all consumers, aggregation creates no problems. Accordingly, advocates of the surplus theory of welfare posit a uniform marginal social welfare gain for an extra dollar for all individuals, not because such uniformity is provable or even likely, but rather because such an assumption is essential to render the theory tractable and consistent.

For example, Nobel laureate Jean Tirole, in his widely used graduate industrial organization textbook, admitted that "extending the single-consumer case to multiple consumers creates new difficulties . . . the issue [being] that aggregate equivalent variation is not, in general, insensitive to redistributions of income between consumers."[57] He continued, "Only under strong conditions can one ignore the distribution of income."[58] Yet, two sentences later, he wrote that he "will treat income distribution as irrelevant."[59]

Marshall himself knew that the assumptions he made to give meaning to aggregate surplus were false, and only used them for convenience. Indeed, he explicitly acknowledged that "[a] greater utility will be required to induce him to buy a thing if he is poor than if he is rich."[60]

In his book, *The Economics of Welfare*, Pigou considered whether output or Gross Domestic Product (GDP) alone could be a measure of welfare, since it increased output-market surplus.[61] He argued that GDP could not, because changes in distribution could cause adverse impacts on welfare even when GDP increased. Moreover, Pigou argued that one had to account for the impact of policy in other markets as well. As a result, Pigou contended that welfare increased when output increased only when distribution is held constant and all other effects in other markets are also accounted for: "It is evident that, provided the dividend accruing to the poor is not diminished, increases in the size of the aggregate national dividend, if they occur in isolation without anything else whatever happening, must involve increases in economic welfare."[62]

But the static distribution assumption is clearly false. Mergers impact distribution. Stakeholders in the merging firms are impacted, and prices and incomes are altered. Nonetheless, because of the false assumption of constant and equal marginal utility of money (or marginal social welfare of money), antitrust is allowed to ignore distribution and proceed as if distribution has no welfare effects.

No economist that the authors are aware of believes that the marginal utility of money actually is constant and equal, or that distribution is not important for welfare.[63] There are several ways to prove that the marginal utility of money is not constant and

57. TIROLE, *supra* note 46, at 12. Aggregate equivalent variation is a modern improvement on the concept of surplus. *See infra* Part II.B.5.

58. TIROLE, *supra* note 46, at 12, 31–39.

59. In defense, Tirole cited the redistributing central authority that we refute in Part IV.B.3, and the Compensation Principle that we refute in Section V. *Id.* at 12; *see also infra* Part IV.B.3, Section V.

60. MARSHALL, supra note 43, at 95.

61. *See generally* PIGOU, *supra* note 48.

62. *Id.* at 82.

63. Joseph Farrell & Michael L. Katz, *The Economics of Welfare Standards in Antitrust*, COMPETITION POL'Y INT'L., Autumn 2006, at 3, 10 ("It is, however, a widely held view that an additional dollar is worth more to society in the hands of a poor person than those of a rich one.").

equal. One way uses the theory of risk aversion. Risk aversion means that people experience more disutility when their wealth declines in value than they gain in utility when their wealth rises by an equal amount.[64] A declining marginal utility from additions in wealth is a necessary condition for risk aversion. Because we know that risk aversion is a widely observed phenomenon, it is patently obvious that the constant marginal utility of money assumption cannot hold. Moreover, today we can measure the marginal utility of money using the tools of welfare economics, and the findings are consistent with a declining marginal utility of money. For example, Layard and DeNeve's 2023 book states:

> An extra $ of income produces a smaller and smaller amount of extra wellbeing the richer the person is. This old idea is now called "the diminishing marginal utility of income"; and before the behaviourist revolution, it was a central belief of every economist. . . .
>
> Until the last few decades, this was simply a speculative belief. But the new science [of welfare] now makes it possible to measure the quantitative effect with some accuracy.[65]

Once one accepts that the marginal utility of money is not constant, or that if marginal utility is constant it is not equal to that of every other consumer, then total utility depends on distribution, even when holding total surplus fixed. Net welfare increases when surplus transfers are made from the rich to the poor. Accepting these realities, surplus loses its meaning as an independent concept separate from distribution and is no longer viable as a measure of welfare.[66]

The remarkable acceptance of the "constant marginal utility of money" distributional assumption by industrial organization economists and antitrust practitioners leads them into untenable ethical territory. Setting aside distribution makes policies that express equal respect and concern for all citizens impossible to justify.[67] Moreover, these assumptions contradict almost all ethical, moral, and religious traditions, which universally hold that distribution matters. The human belief in equal concern for all (or at least all in one's "community," however defined) is fundamental, and likely stems from our basic genetic makeup.[68] Recent research in

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64. ANDREU MAS-COLELL, MICHAEL WHINSTON & JERRY GREEN, MICROECONOMIC THEORY 186 (1995) ("[W]e see that *risk aversion is equivalent to the concavity of* $u(\,)$ and that strict risk aversion is equivalent to the strict concavity of $u(\,)$. This makes sense. Strict concavity means that the marginal utility of money is decreasing. Hence, at any level of wealth x, the utility gain from an extra dollar is smaller than (the absolute value of) the utility loss of having a dollar less. It follows that a risk of gaining or losing a dollar with even probability is not worth taking.").

65. LAYARD & DE NEVE, *supra* note 55, at 204 (emphasis omitted) (citation omitted).

66. Kaldor efficiency and Hicks efficiency reformulate the surplus theory on the basis of ordinal utility. *See* J.R. Hicks, *The Rehabilitation of Consumers' Surplus*, 8 REV. ECON. STUD. 108, 108–10 (1941). However, to avoid the problem of distribution these notions rely on Kaldor's compensation principle. J.R. Hicks, *The Foundations of Welfare Economics*, 49 ECON. J. 696, 700, 710 (1939).

67. WILL KYMLICKA, CONTEMPORARY POLITICAL PHILOSOPHY 32–33 (2002) (arguing that moral philosophers are in basic agreement that a core principle of justice is equal consideration for each person).

68. *See* Kim Sterelny, *How Equality Slipped Away*, AEON (June 10, 2021), https://aeon.co/essays/for-97-of-human-history-equality-was-the-norm-what-happened [https://perma.cc/CB9W-B65M] (noting that through 97% of human history, equality was the norm); M. Dyble, G.D. Salali, N. Chaudhary, A. Page, D. Smith, J. Thompson, L. Vinicius, R. Mace & A.B. Migliano, *Sex Equality Can Explain the Unique Social Structure of Hunter-Gatherer Bands*, 348 SCIENCE 796, 796

anthropology and human biology suggests that "inequality aversion plays an important role in guiding human social decision-making and appears to be ubiquitous across human populations,"[69] presumably because "social groups with more altruists will, for various reasons, outcompete other groups,"[70] or for other reasons such as the necessity of collaboration for survival. Accordingly, an approach that considers only the total surplus and ignores distribution cannot be ethically or scientifically justified.

4. Willingness To Pay Assumes Preferences Are Always Self-Interested and Accurate

The defects in the output market surplus theory of welfare extend well beyond those originally acknowledged by Marshall and Pigou. The intractable problems extend to the use of willingness to pay to measure welfare and the assumptions that go along with it. F.Y. Edgeworth, a founder of neoclassical economics, stated the necessary assumption for using willingness to pay to measure welfare this way: "The first principle of economics is that every agent is actuated only by self-interest."[71] This is an important assumption because, if preferences are not necessarily self-interested, then it cannot be assumed that choices in the market necessarily reflect well-being. For example, as John Broome put the concern:

> To be more exact, the choice needs to be based on good, self-interested reasons. They must be self-interested, because if a person were to make a choice for a reason which was not self-interested, then by considering the choice alone we should not get a proper indication of this person's interest, as opposed to the interests of other people.[72]

But experience tells us that people regularly act in ways that are not purely self-interested. Robert Frank summarized the state of the evidence as follows: "On the strength of the evidence, we must say that the self-interest model provides a woefully inadequate description of the way people actually behave. Yet the model continues to flourish."[73]

Experimental economics also finds that people do not behave in accordance with the self-interest model. Commenting on the totality of the experimental literature, economists Ernst Fehr and Urs Fischbacher stated: "First, during the last decade experimental economists have gathered overwhelming evidence that systematically refutes the self-interest hypothesis . . . . Second, there is also strong evidence indicating

(2015) (noting equality between men and women in hunter-gatherer societies). *See generally* LANTZ MILLER, THE ROOTS OF EQUALITY: ANTHROPOLOGICAL AND NORMATIVE SOURCES (2023); Yun Wang, Dang Zheng, Jie Chen, Li-Lin Rao, Shu Li & Yuan Zhou, *Born for Fairness: Evidence of Genetic Contribution to a Neural Basis of Fairness Intuition*, 14 SOC. COGNITIVE AFFECTIVE NEUROSCIENCE 539 (2019).

69. Katherine Jane McAuliffe, The Evolution and Development of Inequity Aversion, at iii (Mar. 2013) (Ph.D. dissertation, Harvard University), https://dash.harvard.edu/bitstream/handle/1/11156679/McAuliffe_gsas.harvard_0084L_10757.pdf [https://perma.cc/5D22-HXST].

70. Michael Tomasello, Alicia P. Melis, Claudio Tennie, Emily Wyman & Esther Herrmann, *Two Key Steps in the Evolution of Human Cooperation: The Interdependence Hypothesis*, 53 CURRENT ANTHROPOLOGY 673, 673 (2012).

71. SAMUEL BOWLES & HERBERT GINTIS, A COOPERATIVE SPECIES: HUMAN RECIPROCITY AND ITS EVOLUTION 9 (2011) (quoting F.Y. EDGEWORTH, MATHEMATICAL PSYCHICS 17 (1881)).

72. John Broome, *Choice and Value in Economics*, 30 OXFORD ECON. PAPERS 313, 333 (1978).

73. ROBERT FRANK, PASSIONS WITHIN REASON: THE STRATEGIC ROLE OF THE EMOTIONS 256 (1988).

that the deviations from self-interest have a fundamental impact on core issues in economics."[74]

Preferences can be other-regarding, meaning that choices are motivated by their effects on others, thereby compromising the link between choice and individual human welfare. Some choices are altruistic: someone reduces their own well-being to benefit the well-being of others.[75] Altruism by parents and within families is common and explained by the fact that family members carry the altruist's genes.[76] And economists, such as Samuel Bowles and Herbert Gintis, have compiled significant evidence of non-kin-based altruism.[77]

But other-regarding preferences can also be negative. Humans can harbor racial or ethnic bias, can be vengeful, and can at times be sadistic. Legal scholars Matthew Adler and Eric Posner offered the following example:

> Frank has dedicated his life to leading the Ku Klux Klan and working for the oppression of blacks. Frank prefers that they be subordinated. The traditional welfare economist is committed to saying, in this case, that a race-based caste system might be worse for the oppressed but is better for Frank—better quite apart from any change in Frank's material welfare or any other tangible benefit that racial oppression might produce.[78]

Modern welfare economists consider negative, other-regarding preferences as a serious problem for a willingness-to-pay approach to measuring welfare.[79] For example, John Harsanyi, a Nobel Prize winning welfare economist, believed that "we must exclude all clearly antisocial preferences, such as sadism, envy, resentment, and malice."[80] But once we move away from crediting all actual preferences, the process becomes more complicated, because we need an ethical theory to guide what preferences are excluded.[81]

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74. Ernst Fehr & Urs Fischbacher, *Why Social Preferences Matter: The Impact of Non-Selfish Motives on Competition, Cooperation and Incentives*, ECON. J., Mar. 2002, C1, C1. Bowles and Gintis summarized the results of the literature on eight types of experimental games, including the prisoner's dilemma, the dictator game, the ultimatum game, and various public goods games. BOWLES & GINTIS, *supra* note 71, at 19–45.

75. The material welfare economists, such as Pigou and Marshall, focused only on measurable outcomes like number of calories, not freezing, and not being a social outcast. Using this approach, it is easy to identify altruism. What is more difficult is identifying altruism when motives are subjective. *See* PIGOU, *supra* note 48, at 85; MARSHALL, *supra* note 43, at 49.

76. BOWLES & GINTIS, *supra* note 71, at 93–110; *see also* W.D. Hamilton, *The Genetical Evolution of Social Behaviour* (pts. I & II), 7 J. THEORETICAL BIOLOGY 1, 17 (1964).

77. BOWLES & GINTIS, *supra* note 71, at 53.

78. MATTHEW ADLER & ERIC POSNER, NEW FOUNDATIONS OF COST-BENEFIT ANALYSIS 33–34 (2006).

79. Charles Blackorby, Walter Bossert & David Donaldson, *Multi-Profile Welfarism: A Generalization*, 24 SOC. CHOICE & WELFARE 253, 257 (2005) ("Desire and preference accounts identify well-being with the satisfaction of self-interested individual wants. The (hypothetical) person must be fully informed and, for that reason, the preferences thus identified do not, in general, coincide with actual preferences.").

80. John C. Harsanyi, *Morality and the Theory of Rational Behaviour*, *in* UTILITARIANISM AND BEYOND 39, 56 (Amartya Sen & Bernard Williams eds., 1977).

81. Ronald Dworkin argued that it is impossible to avoid counting other-regarding preferences. RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 266–78 (1977). But the crediting of negative other-regarding preferences poses a challenge to democracy. A majority with negative other-regarding preferences can subordinate a minority. Dworkin made the interesting proposal that the foundation of legitimate inherent rights

Another necessary assumption that is required in order to equate preference with improved well-being involves the cognitive competence of human decision-makers. The connection between choice and well-being requires that agents are "rational" in the nontechnical sense that their "beliefs are [not] grossly out of kilter with available evidence."[82] Unfortunately, choices are influenced by the context and framing of the choice.[83]

A further problem pointed out by Nobel Prize winning economist and psychologist Daniel Kahneman is that preference-based choices are merely an ex-ante prediction of the benefit one expects to receive from the choice made. There is often a disconnect, however, between formation of the preference and the actual experience of preference satisfaction. In particular, people are notoriously bad at predicting their degree of adaptation to post-choice situations. For example, people's predictions of the satisfaction from a windfall in income do not take account of the immense ability humans have to adapt to higher income levels. Studies have found that recent lottery winners are no happier than those in a control group, for instance.[84] Economist Bruno Frey, summarizing the experimental literature on forecasting utility, concluded that individuals are not good at foreseeing how much utility they will derive from their future consumption. Research on affective forecasting shows, for instance, that people underestimate their ability to cope with negative effects. Usually, therefore, people have biased expectations about the intensity and duration of emotions. People fail to foresee that they will adapt more in the future than they predict at present.[85]

Behavioral economists and cognitive psychologists have uncovered numerous other examples of misperception and cognitive errors. These errors open a gap between preference, choice, and well-being.[86] In sum, the willingness-to-pay approach to measuring welfare requires a plethora of unwarranted and dubious assumptions. As a consequence, welfare economists working with the cognitive sciences and other social scientists have developed an extensive multidimensional body of evidence concerning the factors that influence welfare.[87] Yet, antitrust economists paradoxically seem to

involves the protection of liberties that are threatened by large external preferences in a community. *Id.* at 275–78.

82. Paul Rozin & Edward Royzman, *Negativity Bias, Negative Dominance, and Contagion*, 5 PERSONALITY & SOC. PSYCH. REV. 269, 306–07 (2001).

83. Daniel Kahneman, Jack Knetsch & Richard Thaler, *The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSPS. 193, 194 (1991).

84. Daniel Kahneman & Carol Varey, *Notes on the Psychology of Utility*, *in* INTERPERSONAL COMPARISONS OF WELL-BEING 127, 141–42 (Jon Elster & John E. Roemer eds., 1991).

85. BRUNO S. FREY & ALOIS STUTZER, HAPPINESS & ECONOMICS 20–25 (2002).

86. DANIEL HAUSMAN, MICHAEL MCPHERSON & DEBRA SATZ, ECONOMIC ANALYSIS, MORAL PHILOSOPHY, AND PUBLIC POLICY 130 (3d ed. 2017) ("The second objection arises from the fact that people are ignorant of many things. Consequentially, people may prefer something that is bad for them because they mistakenly believe it is beneficial. It is not true that x is better for A than y if and only if A prefers x to y. Indeed, many people live in circumstances in which their governments, their poverty, or their lack of education makes it almost impossible for them to make informed choices.").

87. *See, e.g.*, BRUNO S. FREY, HAPPINESS: A REVOLUTION IN ECONOMICS (2008); MARK ANIELSKI, THE ECONOMICS OF HAPPINESS: BUILDING GENUINE WEALTH (2007); JOSEPH STIGLITZ, AMARTYA SEN & JEAN-PAUL FITOUSSI, MISMEASURING OUR LIVES: WHY GDP DOESN'T ADD UP (2010); ALEX MICHALOS, DEVELOPMENT OF QUALITY OF LIFE THEORY AND ITS INSTRUMENTS (2011); DANIEL KAHNEMAN, ED DIENER & VORBERT SCHWARZ, WELL-BEING: THE FOUNDATIONS OF HEDONIC PSYCHOLOGY (1999).

remain willfully ignorant of this work. Section VI argues that this literature should replace the surplus approach in guiding antitrust policy.

5. Additional Inconsistencies of the Surplus Approach

Marshall measured an individual's demand curve at the amounts the consumer was willing to pay for each marginal quantity of the product. However, Marshall did not correct for changes in income remaining as the consumer made marginal purchases. Kaldor and Hicks reformulated Marshall's consumer surplus model in a way that is consistent with ordinal utility, an improvement over Marshall, and these contributions fixed Marshall's "constant income" mistake. To do so, Kaldor and Hicks defined the concepts of "compensating variation" (CV) and "equivalent variation" (EV); equivalently, one can use "willingness (and ability) to pay" (WATP) and "willingness to accept" (WTA). Consumer surplus lies between EV and CV (equivalently, between WATP and WTA). This dual nature of value, while incontestably more correct than the surplus approach, turned out to be even more problematic, however, because EV and CV can be inconsistent. EV and CV can result in different policy recommendations, or they can recommend one policy but once implemented can then dictate that the original policy be restored, as was first pointed out by economist Tibor Scitovsky.[88] These problems are incurable.[89] To ensure consistency, all individuals must have preferences that are quasi-homothetic and identical at the margin.[90] This means, for example, that if you make $100 each week and spend $10 on pizza, then when your income increases to $100,000 a week you must spend $10,000 on pizza.[91]

The accumulation of such problems has led welfare economists to reject the surplus approach. As Antoinette Baujard, a prominent welfare economist, described, "[e]xtremely serious . . . [criticisms] have been raised against this approach by the leading experts in the field."[92] The 2015 Economics Nobel laureate Angus Deaton famously concluded that "there is no valid theoretical or practical reason for ever integrating under a Marshallian demand curve" (that is, calculating consumer surplus).[93]

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88. *See generally* T. de Scitovszky, *A Note on Welfare Propositions in Economics*, 9 REV. ECON. STUD. 77 (1941). His name is sometimes spelled "Scitovszky" or "de Scitovszky." *See id.*

89. *See generally* Charles Blackorby & David Donaldson, *A Review Article: The Case Against the Use of the Sum of Compensating Variations in Cost-Benefit Analysis*, 23 CAN. J. ECON. 471 (1990); Kjell Arne Brekke, *The Numéraire Matters in Cost-Benefit Analysis*, 64 J. PUB. ECON. 117 (1997).

90. Blackorby & Donaldson, *supra* note 89, at 473; *see also* W.M. Gorman, *The Intransitivity of Certain Criteria Used in Welfare Economics*, 7 OXFORD ECON. PAPERS 25, 28 (1955).

91. We have summarized this problem and several others in a previous work. *See generally* Glick et al., *supra* note 2.

92. Antoinette Baujard, *Welfare Economics*, (Groupe d'Analyse et de Théorie Economique Lyon-St Étienne, Working Paper No. 1333, 2013), https://shs.hal.science/halshs-00906907/document [https://perma.cc/4EAJ-7FTM] (first citing KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (2d ed. 1963); and then citing ROBIN BOADWAY & NEIL BRUCE, WELFARE ECONOMICS (1984)) (describing the main problems with this approach and listing prominent welfare economists that criticize it).

93. Marco Becht, *The Theory and Estimation of Individual and Social Welfare Measures*, 9 J. ECON. SURVEYS 53, 77 (1995) (quoting Angus Deaton, *Demand Analysis*, *in* 3 HANDBOOK OF ECONOMETRICS 1767, 1828 (Zvi Griliches & Michael D. Intriligator eds., 1986)).

In sum, cost savings cannot be assumed to result in welfare increases based on a surplus theory of welfare. The surplus theory is too riddled with wildly unrealistic assumptions and problems to be a reliable link between cost savings and welfare. Nor is there any basis in economics for referring to cost savings, even with a positive welfare effect, as "efficiencies." In economics, efficiency refers to Pareto efficiency. But maybe the surplus approach can be resurrected by connecting it to Pareto efficiency? In that case, perhaps Pareto efficiency could be extended to cost savings. But, as Section III establishes, that also is a false hope.

III. THE PARETO THEORY OF WELFARE AND OF EFFICIENCY

Even at the time Marshall advanced his theory of consumer surplus, it was met with considerable skepticism. Partially in response to that skepticism, Vilfredo Pareto developed welfare economics in a manner that did not assume comparability of individual utility. Pareto's theory also made it possible to consider all markets simultaneously.

In 1906, Pareto published his *Manual of Political Economy,* in which he developed the Pareto Principle.[94] He defined "Pareto improvements" as changes in which at least one agent is benefitted, while none are harmed. (The amount of benefit, which would be cardinal, is irrelevant: only direction matters.) Pareto defined, for the first time, the word "efficiency" in the context of economic policy: he defined a situation to be "efficient" if no Pareto improvements from it are possible, meaning that there is no possible change that would benefit one agent without making another worse off.[95]

Pareto permeates the discipline of economics. *Every* major first-year Ph.D.-level microeconomics textbook today adopts Pareto's definition of efficiency, although they sometimes redundantly introduce the terms "Pareto efficiency" and "Pareto optimality" as synonyms for "efficiency." (Even more confusing is economists' penchant to use "optimality" as a synonym for "Pareto optimality" even though this clashes with economists' use of the word "optimal" in many other contexts.) In the well-known texts of Hal Varian,[96] and of Geoffrey Jehle and Philip Reny,[97] the word "efficiency" is *exclusively* used as a synonym for Pareto efficiency. In Andreu Mas-Colell, Michael

94. *See generally* VILFREDO PARETO, MANUAL OF POLITICAL ECONOMY (Aldo Montesano, Alberto Zanni, Luigino Bruni, John S. Chipman & Michael McLure eds., 2014) (1906).

95. This definition is well known in economics. *See, e.g.*, MAS-COLELL ET AL., *supra* note 64, at 307–08 ("An economic outcome is said to be Pareto optimal if it is impossible to make some individuals better off without making some other individuals worse off. This concept is a formalization of the idea that there is no waste in society, and it conveniently separates the issue of economic efficiency from more controversial (and political) questions regarding the ideal *distribution* of well-being across individuals.").

96. Varian neither defined nor used the single word "efficiency" in the text of his book. It appears in some of his headings, such as "13.10 Efficiency and Welfare," but the accompanying text always puts the word "Pareto" before "efficiency." *See, e.g.*, HAL R. VARIAN, MICROECONOMIC ANALYSIS 226, 227 (3d ed. 1992).

97. *See, e.g.*, GEOFFREY A. JEHLE & PHILIP J. RENY, ADVANCED MICROECONOMIC THEORY 186 (3d ed. 2011) ("Now it would seem that to obtain an *efficient* outcome, the total surplus—the sum of consumer and producer surplus—must be maximised. Otherwise, *both* the producer and the consumer *could be made better off* by redistributing resources to increase the total surplus, and then dividing the larger surplus among them so that each obtains strictly more surplus than before. But we must take care." (emphases added)).

Whinston, and Jerry Green's text, *Microeconomic Theory* (MCWG),[98] all but one use of the word "efficiency" in the main text refers to Pareto efficiency.[99]

Thus, the question arises: Might Pareto efficiency provide a usable alternative or enhancement to surplus theory in antitrust analysis? To answer this question, we must first examine the conditions for Pareto efficiency, its ethical attractiveness, and its drawbacks, because such an understanding is a necessary foundation to considering the relationship between Pareto efficiency, surplus theory, and cost savings.

A. Conditions for Pareto Efficiency

There are three necessary conditions for a Pareto optimum: distribution efficiency, production efficiency, and allocative efficiency. These conditions define what economists mean by efficiency and the various types of efficiency.

Distribution efficiency can be defined in a simple pure exchange economy (i.e., an economy with no production). In such an economy, provided certain simplifying assumptions are made, a Pareto efficient allocation has the following property: suppose that, upon taking one unit of a commodity—say, apples—from one person—say, Jones—it is the case that Jones would accept "*x*" units of another commodity—say, bananas—as full compensation for his loss of the apple. The number *x* is called Jones's marginal rate of substitution (MRS) of bananas for apples. At a Pareto efficient allocation, i.e., where no more Pareto improvements are possible, all persons in the economy must have equal MRS of bananas for apples.[100] In this situation, where the economy is limited to exchange, we say that we have achieved "distributive efficiency."

Production efficiency occurs when firms have exhausted all voluntary mutually beneficial trades of inputs. This occurs in an economy with production when the "marginal rate of technical substitution" (MRTS) (also known as the "rate of technical substitution") of the contribution that different "factors of production" (for example, land and irrigation water) make to output (for example, apples or bananas) are all equal. The "MRTS of land for water in the production of apples" is the extra amount of land

98. MAS-COLELL ET AL., *supra* note 64.

99. *See, e.g.*, *id.* at 307–08. Although nowhere in the main text of the book is there an instance of "efficiency" being used in the sense of "cost saving," there is one footnote in the book that does use "efficiency" that way: "An example where the assumption of an optimal allocation of production is not valid is the Cournot duopoly model of Chapter 12 when firms have different efficiencies. There, firms with different costs have different levels of marginal cost in an equilibrium." *Id.* at 330 n.18.

100. The proof of this result is by contradiction. Begin by supposing that the situation is Pareto efficient but that there are two consumers, Jones and Smith, whose MRS's of apples for bananas are different. Suppose Jones's MRS is three and Smith's MRS is two. Now take an apple away from Smith. Give Smith two bananas taken from Jones, thus leaving Smith as well off as she was initially; and give Jones the apple taken from Smith. Had Jones been left with one more apple and three fewer bananas, Jones would have been as well off as he was originally, but he is actually left with one more apple and two fewer bananas, so he is better off than he was originally. With Smith as equally well off as she was originally and Jones better off than he was originally, the original situation cannot have been Pareto efficient because additional improvement was possible. This contradiction establishes the proof. The case in which Jones's MRS was less than Smith's is proven similarly. For a discussion of this and other issues with Pareto efficiency, see Mark Glick & Gabriel A. Lozada, *The Erroneous Foundations of Law & Economics* (Inst. for New Econ. Thinking, Working Paper No. 149, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3812839 [https://perma.cc/SX4C-DJQK].

needed to keep the number of apples produced constant if one reduced the amount of water used by one unit. In an economy with more than one output, Pareto efficiency requires "efficient production," which in turn requires MRTS to be equal in each industry; otherwise, a rearrangement of the utilization of the factors of production could result in greater output of one commodity and no smaller output of any other commodity. Thus, for example, "efficient production" would require equality of "the MRTS of land for water in the production of apples" and "the MRTS of land for water in the production of bananas."

Finally, allocative efficiency occurs when neither an economy's utilization of its factors of production nor its distribution of produced goods can be altered to make some people better off without making some others worse off. An economy has allocative efficiency if it has both distribution efficiency and production efficiency. When economists refer to "efficiency" (modified by no adjective) in an economy with production, they mean "allocative efficiency." An economy with production is Pareto efficient if and only if it has allocative efficiency.[101]

B. The Attractiveness of and Objections to Pareto Efficiency

Pareto efficiency has several admirable qualities lacking in the surplus approach, principally the ability to avoid most of the questionable assumptions required by the surplus approach. Pareto efficiency does not require an assumption of cardinal utility, it does not require assuming constant and equal marginal utility of money, and it considers the impact of all markets in the economy. This gives Pareto efficiency theoretical appeal.

Pareto efficiency is also ethically attractive because policy change is recommended only if no individual is harmed. In this respect, all individuals are treated with equal consideration, because policy change requires unanimous consent. This is sometimes referred to as "the principle of minimal benevolence."[102]

On the other hand, Pareto's approach is not value neutral. Pareto's theory attributes no value to increased equality. An allocation that gives all society's goods and services to one person and lets all other people starve to death is Pareto efficient

101. The proof of this result is too lengthy to present here, but we can show the proof of a closely related result in a model with a simpler description of production. To this end, abstract away from factors of production (land and irrigation water, in our discussion above), and define the "marginal rate of transformation" (MRT) to refer to the ultimate tradeoff at the margin between apple output and banana output. In particular, assume that, adjusting land and irrigation water appropriately, reducing output by one apple would result in the ability to produce four more bananas, and vice versa, so that the MRT of bananas for apples is four. Under such circumstances, any situation in which the common MRS of bananas for apples of Jones and of Smith was not equal to four would not be Pareto optimal. To prove this, assume by way of contradiction that the situation is Pareto optimal but that the MRT is not equal to the MRS: suppose that although the MRT of bananas for apples is four, the MRS of bananas for apples of Jones and Smith is five. Create two more apples, one each for Jones and Smith, by using as inputs eight bananas, four each from Jones and Smith. Each person now has one more apple and four fewer bananas. Had each person been left with one more apple and five fewer bananas, they would be equally as well off as before, but actually they are left with one more apple and four fewer bananas, so they are better off than they were before; hence, the original situation was not Pareto optimal. The case in which the MRT is greater than the joint MRS is proven similarly. *See* Glick & Lozada, *supra* note 100.

102. HAUSMAN ET AL., *supra* note 86, at 150.

(assuming no other-regarding preferences). Additionally, a policy that did slight harm to one person but enormously benefitted millions of others would not pass muster under the Pareto principle.

Nonetheless, because of the attractiveness of Pareto efficiency, and because economics has adopted Pareto's principle as the definition of "efficiency," some antitrust economists and scholars have attempted to derive the surplus theory from Pareto efficiency and thereby link cost savings to economic efficiency (that is, to Pareto efficiency). Before addressing these attempts, two more economics concepts must be defined: the first fundamental theorem of welfare economics and the theory of the second best. These concepts will be necessary to evaluate the link between cost savings and Pareto efficiency discussed in Section IV below.

C. An Explanation of the First Fundamental Theorem of Welfare Economics

Pareto efficiency is incorporated into two formal theorems of welfare economics. This Part addresses the first fundamental theorem of welfare economics, which was originally proven by Oskar Lange, Abba Lerner, and Harold Hotelling, and was later generalized by Kenneth Arrow and Gerard Debreu.[103]

The first fundamental theorem deals with perfectly competitive economies. "Perfect competition" is defined as a situation in which all economic agents are price takers—they believe they are unable to affect any of the prices relevant to themselves (input prices or output prices). Such a belief would only be rational if there were an infinity of infinitely small firms, which is obviously very different from today's economy. Note that a necessary condition for a perfectly competitive equilibrium to exist in the first place is that no sector of the economy has increasing returns to scale (because a perfectly competitive firm's optimal output under increasing returns to scale, assuming there exists some output level generating positive profit, is infinity, which cannot be an equilibrium level of output). Of course, if no sector of the economy had increasing returns to scale, few mergers would ever generate cost savings; instead, one might expect that firm breakups would generate cost savings, or that firms of any size would be equally prosperous. This should be a clue that the first theorem of welfare economics would have problematic relevance to antitrust policy in a modern economy.

The first fundamental theorem states that, under a particular set of further unrealistic assumptions, perfectly competitive equilibria are Pareto optimal.[104] The further unrealistic assumptions are: (1) there are no externalities, (2) there are no barriers to entry, and (3) all agents have the same information. We will refer to perfect competition, no increasing returns to scale, and the three additional assumptions itemized above as the "Arrow-Debreu assumptions." When the Arrow-Debreu assumptions hold, perfect competition is Pareto efficient. This is the first fundamental theorem of welfare economics.

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103. *See* Baujard, *supra* note 92, at 6.

104. *Id.* at 7 (noting that preferences must also be monotonic and markets must be complete).

D. An Explanation of the Theory of the Second Best

The first theorem derives part of its importance from another result: when the Arrow-Debreu assumptions hold, at least one perfectly competitive equilibrium exists. This additional result ensures that the first theorem is not empty. However, this is a theorem of existence, not directionality—that is, nothing in this existence theorem establishes that an Arrow-Debreu economy would ever *move* in the direction of perfectly competitive equilibrium. The existence theorem is solely a proof of existence—it asserts no dynamic theory of stability or convergence,[105] and attempts to add such a theory later are hindered by the Sonnenschein-Mantel-Debreu theorem that excess demand functions need not be well-behaved and can have any shape.[106] Furthermore, the real economy is not perfectly competitive, because it does not even approximately obey the Arrow-Debreu assumptions. If it did, antitrust problems would not exist.

To evaluate the efforts to link cost savings with Pareto efficiency we must also introduce the theory of the second best. R. G. Lipsey and Kelvin Lancaster's article *The General Theory of the Second Best*[107] shows that if the economy is not perfectly competitive, then any incomplete move in the direction of perfect competition can reduce welfare rather than increase it.[108] The theory of the second best emphasizes how pitifully little can be said about how to improve an economy which is short of attaining "perfect competition everywhere."[109]

To be more precise, the theory of the second best states that if there are more than zero deviations from the Arrow-Debreu assumptions, there are situations in which

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105. *See* Frank Ackerman, *Still Dead After All These Years: Interpreting the Failure of General Equilibrium*, 9 J. ECON. METHODOLOGY 119, 120 (2002) ("The equilibrium in a general equilibrium model is not necessarily either unique or stable, and there are apparently no grounds for dismissing such ill-behaved outcomes as implausible special cases."); Duncan K. Foley, *What's Wrong with the Fundamental Existence and Welfare Theorems?*, 75 J. ECON. BEHAV. & ORG. 115, 119 (2010) ("[N]o robust account of the stability of an exchange economy toward the set of Walrasian allocations exists.").

106. Hugo Sonnenschein, *Market Excess Demand Functions*, 40 ECONOMETRICA 549, 549 (1972); Rolf R. Mantel, *On the Characterization of Aggregate Excess Demand*, 7 J. ECON. THEORY 348 (1974); Hugo Sonnenschein, *Do Walras' Identity and Continuity Characterize the Class of Community Excess Demand Functions?*, 6 J. ECON. THEORY 345 (1973); Gerard Debreu, *Excess Demand Functions*, 1 J. MATHEMATICAL ECON., 15, 15 (1974); S. Abu Turab Rizvi, *The Sonnenschein-Mantel-Debreu Results After Thirty Years*, 38 HIST. POL. ECON. 228, 230 (2006).

107. R.G. Lipsey & Kelvin Lancaster, *The General Theory of the Second Best*, 24 REV. ECON. STUD. 11 (1956).

108. According to Professor Richard S. Markovits, this follows although "law-and-economics scholars and various other sorts of economists [have] chosen to ignore it." Richard S. Markovits, *Second-Best Theory and Law & Economics: An Introduction*, 73 CHI.-KENT L. REV. 3, 3, 7–8 (1998).

109. *See* Lipsey & Lancaster, *supra* note 107, at 17. More precisely, they note:

> It should be obvious from the discussion in the preceding sections that the principles of the general theory of second best show the futility of "piecemeal welfare economics." To apply to only a small part of an economy welfare rules which would lead to a Paretian optimum if they were applied everywhere, may move the economy away from, not toward, a second best optimum position. A nationalized industry conducting its price-output policy according to the Lerner-Lange "Rule" in an imperfectly competitive economy may well diminish both the general productive efficiency of the economy and the welfare of its members.

Id. (footnote omitted).

adding another deviation from the Arrow-Debreu assumptions will be welfare improving (i.e., will be a Pareto improvement). For example, if an industry is using a polluting technology, then in the absence of any government pollution regulation, allowing the industry to merge to monopoly might increase welfare, because it will reduce output and thus reduce pollution. Or consider another example: if firms in an industry have some monopsony power in the labor market, because they are the only buyers, then allowing the workers to unionize might increase welfare, because it might raise wages back towards their competitive level.[110] It follows from the above that antitrust efforts to get "closer" to the Arrow-Debreu conditions may well be misguided because they could result in lower welfare.

In sum, all economics can tell us is that if the economy were in a position of perfect competition, then it would be Pareto efficient. But there is no theory that establishes that an economy would ever achieve this state on its own, nor that intervention to improve competition in some part of the economy would move us closer to Pareto efficiency (i.e., would be a Pareto-improving move). This creates a challenge for economists who wish to show that cost savings or "more competition" can advance the economy toward greater Pareto efficiency. We now turn to those theories and demonstrate their inability to salvage the "efficiency as cost savings" approach.

IV. THEORIES THAT ATTEMPT TO DERIVE THE SURPLUS THEORY AND THE BENEFIT OF COST SAVINGS FROM PARETO EFFICIENCY

This Section describes two attempts by antitrust economists to tether the surplus theory to Pareto efficiency and thereby provide a link between cost savings and "efficiency" as understood by economists. Both rely on the concepts explained in Section III.

A. Deriving Efficiency of Consumer and Producer Surplus from the First Fundamental Theorem of Welfare Economics

Several industrial organization textbooks and antitrust papers attempt to link the sum of consumer and producer surplus to Pareto efficiency by use of the first fundamental theorem of welfare economics. The implication is that surplus can be thought of as efficiency because of its relationship to Pareto efficiency, and that cost savings that increase surplus are also, therefore, a valid type of efficiency. The argument proceeds as follows: according to the first fundamental welfare theorem, perfect competition is Pareto efficient. In perfect competition, price is equal to marginal cost in all markets. Now the link: when price equals marginal cost, the sum of consumer and producer surplus is at its maximum. Thus, maximizing consumer and producer welfare results in Pareto efficiency. One can find this argument in the industrial organization textbooks authored by Kip Viscusi, John Vernon, and Joseph

110. Eugene K. Kim, *Labor's Antitrust Problem: A Case for Worker Welfare*, 130 YALE L.J. 428, 436–38. Unions *might* raise wages "too much," above their competitive level, and even so much that unionization reduces welfare. However, the idea that the competitive level is the optimal one is itself only true if all other markets in the economy are perfectly competitive, because of the theory of the second best. Therefore, in the real world, determining the theoretically desirable wage level would be difficult.

Harrington,[111] and Giles Burgess.[112] It reappears in Kolasky and Dick's 2003 merger efficiency paper,[113] and in the Ph.D. microeconomics textbooks by Varian[114] and by Jehle and Reny.[115]

In our view, the argument is both misleading and has, at best, only marginal utility because of its reliance on the assumption of perfectly competitive markets (including a full set of futures markets). The fact that in a perfectly competitive equilibrium the economy achieves both Pareto efficiency and maximum consumer and producer surplus means very little for antitrust policy in the real world, because of the theory of the second best. Because perfectly competitive markets do not exist, increasing consumer and producer surplus in any actual economy does not necessarily move the economy closer to Pareto efficiency. One cannot even say that decreasing the number of competitors in any market decreases social welfare—it does not, for example, in our earlier example of an industry of polluting firms.

Presumably, the authors of these textbooks understand the limitations and unrealistic assumptions of their argument. Yet, remarkably, they are willing to present it with, at best, caveats banished to footnotes, thereby creating the impression that such caveats can be ignored. This is a disservice to readers interested in applying economics to antitrust policy.

B. The Assumptions Necessary To Derive Surplus Theory from Pareto Efficiency

In his paper *Essays on Consumer Welfare and Competition Policy*, Gregory Werden, then-senior economic counsel at the FTC, set forth the correct relationship between Pareto optimality and total surplus:

> Following the formal analysis of Mas-Colell, Whinston and Green . . . changes in total surplus can be related directly to changes in social welfare if three assumptions are made. First, due to the smallness of the part of the economy under study, prices in the rest of the economy are unaffected, so all other goods are treated as a single composite good—a "numeraire." Second, each consumer's utility equals the amount consumed of the numeraire plus a function of the amount consumed in the market under

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111. W. KIP VISCUSI, JOHN VERNON & JOSEPH HARRINGTON, JR., ECONOMICS OF REGULATION AND ANTITRUST 75–76 (3d ed. 2001). However, the authors make clear that the argument is flawed. For example:

> Many of the listed assumptions will be relaxed and discussed in detail throughout this book. . . .
>
> Once we begin to relax these assumptions, it becomes clear that we need to develop partial equilibrium tools. That is to say, it becomes incredibly complex to deal with a general equilibrium model in which some markets are monopolies, externalities exist, imperfect information about product quality obtains, and so on. Hence, we now turn to welfare economics concepts in the context of a single market . . . .

Id. (footnote omitted) (citing Lipsey & Lancaster, *supra* note 107).

112. *See generally* GILES H. BURGESS, THE ECONOMICS OF REGULATION AND ANTITRUST (1997).

113. Kolasky & Dick, *supra* note 21, at 242–43.

114. VARIAN, *supra* note 96, at 222–25.

115. JEHLE & RENY, *supra* note 97, § 4.3.3, at 186–87.

study. Third, a redistributive mechanism allocates the numeraire in the socially optimal manner. [116]

Werden was correct that, under these three assumptions made by MCWG, a relationship between Pareto efficiency and consumer and producer surplus could be established.[117] What is remarkable is that Werden offered no comment on the nonsensical and fanciful nature of these assumptions.[118]

To be precise, if the first two assumptions are satisfied, then maximizing the surplus in each single market (i.e., "in partial equilibrium") achieves a Pareto efficient allocation for the entire economy.[119] The third assumption is only required in order to go beyond Pareto efficiency and maximize social welfare. We next consider the realism of these assumptions one by one.

1. The Market Must Be Tiny, and All Other Markets Must Be Perfectly Competitive, and the Arrow-Debreu Assumptions Must Hold

The first assumption has several parts, only the first of which is alluded to by Werden. He said that the market of concern must be so tiny that "prices in the rest of the economy are unaffected, so all other goods are treated as a single composite good—a 'numeraire.'"[120] Because MCWG recognized this as a very strong assumption, they noted that it can be replaced by instead assuming that the nonsubstitution theorem applies. This roughly means that the numeraire must be the only nonproduced input into production, that there can be no joint production anywhere in the economy, and that all other sectors must have constant returns to scale.[121] But, the nonsubstitution theorem assumptions seem even less realistic than the "tiny market" assumption.[122]

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116. Gregory J. Werden, *Essays on Consumer Welfare and Competition Policy*, SSRN, at 2 (Mar. 2, 2009) [hereinafter Werden, *Consumer Welfare*], https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1352032 [https://perma.cc/M57Q-XPJT]; *see also* MAS-COLELL ET AL., *supra* note 64, at 316–34.

117. MAS-COLELL ET AL., *supra* note 64, at 328–34.

118. Werden, *Consumer Welfare*, *supra* note 116, at 2. This is the case even though MCWG themselves clearly lay out these assumptions in their sections 10.E and 10.G. *See* MAS-COLELL ET AL., *supra* note 64, at 328–34, 341–44.

119. This is MCWG's Proposition 10.D.1. *See* MAS-COLELL ET AL., *supra* note 64, at 325–26.

120. Werden, *Consumer Welfare*, *supra* note 116, at 2.

121. MAS-COLELL, ET AL., *supra* note 64, at 342 ("[T]he nonsubstitution theorem . . . implies that the prices of all other goods will remain fixed if the numeraire is the only primary (i.e., nonproduced) factor, all produced goods other than l are produced under conditions of constant returns using the numeraire and produced commodities other than l as inputs, and there is no joint production.").

122. MCWG suggested another way out of the tiny market assumption, but it did not help much either. They wrote:

> Even when we cannot assume that all other prices are fixed, however, a generalization of our single-market partial equilibrium analysis is sometimes possible. Often we are interested not in a single market but in a group of commodities that are strongly interrelated either in consumers' tastes (tea and coffee are the classic examples) or in firms' technologies. In this case, studying one market at a time while keeping other prices fixed is no longer a useful approach because what matters is the simultaneous determination of all prices in the group. However, if the prices of goods outside the group may be regarded as unaffected by changes within the markets for this group of commodities, and if there are no wealth effects for commodities in the group, then we can extend much of the analysis presented in Sections 10.C to 10.F.

What Werden did not mention is that the tiny market assumption is not the only condition placed on other markets. There is an even more seriously problematic assumption described by MCWG:

> We conclude this section with a warning: When the numeraire represents many goods, the welfare analysis we have performed is justified only if the prices of goods other than good *l* are undistorted in the sense that they equal these goods' true marginal utilities and production costs. Hence, these other markets must be competitive, and all market participants must face the same price. If this condition does not hold, then the costs of production faced by producers of good *l* do not reflect the true social costs incurred from their use of these goods as inputs.[123]

The actual assumption is that *all the other markets must be perfectly competitive*, and there must be *no distortionary taxes anywhere, nor any externalities.*[124] These conditions should not be surprising, given our remarks above about the theory of the second best: maximizing surplus *in this one market* turns out to achieve a perfectly competitive equilibrium and maximizes welfare, but only if all the other markets are *also* in perfectly competitive equilibrium.[125] If one of the other markets is not perfectly competitive or has an externality, then maximizing surplus in this one market, thereby achieving perfectly competitive equilibrium in this one market, has no guaranteed welfare implications, and might make welfare worse.

But, in the real world, the "other" markets will never all be perfectly competitive and free of externalities. If they were, antitrust would only be a concern in a single industry. Consequently, maximizing surplus does not, in the real world, lead to Pareto efficiency. The obvious conclusion economists should have drawn is that the surplus theory cannot be linked to Pareto efficiency. Yet, remarkably, this is not the conclusion conveyed to students. Moreover, there is no defensible retreat to the proposition that "the closer we get to a world of perfect competition and no market distortions, the closer surplus maximization will approximate Pareto Efficiency." The theory of the second best establishes that getting closer does not necessarily make things better.

2. Utility Must Be Quasilinear

Now, consider the second assumption. In Werden's words, "each consumer's utility equals the amount consumed of the numeraire plus a function of the amount consumed in the market under study."[126] This is the "quasilinear utility" assumption that in MCWG's notation requires individuals' utility to have the form $m + \phi(x)$ where m is the composite "numeraire" good and x is the good under study.[127] The practical implication of this mathematics is stated clearly: "Recall that with quasilinear

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Id. (emphasis omitted). However, these two "if" clauses are only slightly weaker than the conditions laid out in the body of our discussion of the tiny market's heroic assumptions.

123. MAS-COLELL ET AL., supra note 64, at 334.

124. Thus, the assumption requires that proper taxes have been imposed so that the externalities' prices are undistorted. But how are the proper taxes to be calculated when the externality is intertemporal and multigenerational, as in climate change?

125. *See supra* notes 101–124 and accompanying text.

126. Werden, *Consumer Welfare*, *supra* note 116, at 2.

127. MAS-COLELL ET AL., *supra* note 64, at 317.

utility functions, wealth effects for non-numeraire commodities are null."[128] In other words, *everyone in the entire economy has to consume an identical amount of the good x under study* (assuming everyone faces the same prices). That is what "null (or no) wealth effect" or "null (or no) income effect" actually implies. Note the condition is not that everyone has to spend an identical *proportion* of their budget on this good—instead, everyone has to consume precisely the same *amount* of this good.[129] This is complete fiction, not serious social science.

MCWG describe the assumption as follows (note that their "x" is their consumer's consumption of their "good l"):

> The assumption of no wealth effects for good l, on the other hand, is critical for the validity of the style of welfare analysis that we have carried out in this chapter. Without it . . . Pareto optimality cannot be determined independently from the particular distribution of welfare sought, and we already know . . . that area measures calculated from Walrasian demand functions [i.e., surplus measures] are not generally correct measures of compensating or equivalent variations (for which the Hicksian demand functions should be used).[130]

The implication is clear. If everyone in the entire economy is not consuming an identical amount of the good under study, there is no way to get from "surplus in one market" to Pareto efficiency. This unreasonable assumption further breaks any realistic link between consumer and producer surplus and Pareto efficiency.[131]

3. There Must Be a Social Planner To Establish that Maximizing Surplus Maximizes Welfare

The third assumption takes us even farther afield from reality. To show that maximizing surplus actually leads to the unique socially optimal allocation for *any* social welfare function would require a truly bizarre assumption. It requires that there is an omniscient and omnipotent social planner who "allocates the numeraire in the socially optimal manner."[132] As MCWG described:

> In the discussion that follows, we assume that the welfare judgments of society are embodied in a social welfare function $W(u_1, \ldots, u_I)$ assigning a social welfare value to every utility vector $(u_1, \ldots, u_I)$. . . . In addition, we suppose that (as in the theory of the normative representative consumer . . .)

128. *Id.*

129. What if your budget is insufficient to consume this amount? Why, then you just consume negative amounts of some other goods! Their exact quotation is: "We let each consumer's consumption set be $\mathbb{R} \times \mathbb{R}_+$, and so we assume for convenience that consumption of the numeraire commodity m can take negative values. This is to avoid dealing with boundary problems." *Id.*

130. *Id.* at 343.

131. Yet, it is regrettably common for economists to adopt the assumption of quasilinear utility, arguing that income effects are "small," and pointing as evidence to a famous 1976 paper by Robert Willig. *See* Robert Willig, *Consumer Surplus Without Apology*, 66 AM. ECON. REV. 589 (1976). However, even in Willig's paper, hiding in plain sight in Table 1 is one entry having the relative error of using consumer surplus instead of an exact welfare measure as being 125%. *Id.* at 595 tbl.1. See MAS-COLELL ET AL., *supra* note 64, at 90 for a discussion regarding consumer surplus that "the approximation error may be quite large *as a fraction of the deadweight loss.*"

132. Werden, *Consumer Welfare*, *supra* note 116, at 2.

> there is some central authority who redistributes wealth by means of [lump sum] transfers of the numeraire commodity in order to maximize social welfare. The critical simplification offered by the quasilinear specification of individual utility functions is that when there is a central authority who redistributes wealth in this manner, *changes in social welfare can be measured by changes in the Marshallian aggregate surplus . . . for any social welfare function that society may have*.[133]

The existence of this benevolent, omniscient central authority is unrealistic to the point of absurdity, but it is important to realize how heavily many economists depend on that assumption, and for how long they have done so. A revealing example is in Tirole's textbook, where one reads:

> Market intervention does have desirable or undesirable income-redistribution effects. But I will [be] . . . using Musgrave's framework in which the distribution branch of government worries about distribution and the allocation branch . . . deals with efficiency. . . . The classic drawback of this approach is that the distribution branch may not function, and compensation need not occur. *This caveat should be borne in mind in all our welfare conclusions.* For instance, the conclusion . . . that allowing a monopolist to price-discriminate perfectly improves welfare would be reversed if social planners were to put a much higher weight on the consumers' incomes than on the incomes of the firm's shareholders.[134]

Positing the existence of this nonexistent benevolent central authority is pernicious beyond the fact that no such entity exists.[135] To the extent this assumption leads to the approval of more mergers, there are increased resources that will be spent to influence governments to establish rules that favor big business, not to distribute welfare.[136]

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133. MAS-COLELL ET AL., *supra* note 64, at 328.

134. TIROLE, *supra* note 46, at 12 (emphasis added) (citation omitted).

135. *See* Carl Shapiro, *Antitrust: What Went Wrong and How To Fix It*, ANTITRUST, Summer 2021, at 33, 42 ("The Populists implicate lax antitrust as the central cause of many of our social and economic problems, while I see other public policy failures—including weak voter-protection and anti-corruption laws, inadequate protections for workers, highly unequal access to education and health care, and a tax system that contains many regressive elements—as the central culprits."). But the "other public policy failures" are *caused* by lax antitrust. Shapiro objected, using the UK and France as counterexamples. *Id.*

136. *See* MORDECAI KURZ, THE MARKET POWER OF TECHNOLOGY: UNDERSTANDING THE SECOND GILDED AGE 4 (2023) ("I therefore argue that, unrestrained by policy, rising market power threatens the foundation of democratic institutions."). For empirical evidence of this see Bo Cowgill, Andrea Prat & Tommaso Valletti, *Political Power and Market Power*, SSRN, 1, 4 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4390776 [https://perma.cc/4SUU-EQBF] (last updated Nov. 10, 2023) (finding that "a positive association between mergers" and lobbying as well as "some evidence for a[] [positive] association of mergers with campaign contributions"), and Juan Pablo González & Hye Young You, *Money and Cooperative Federalism: Evidence from the EPA Civil Litigation*, 3–4 (PIEP Conf., 2022), https://piep.conferences.wcfia.harvard.edu/sites/projects.iq.harvard.edu/files/piep/files/epa_01.pdf [https://perma.cc/CFE6-E7JU] (finding a positive correlation between campaign contributions to Republicans, but not Democrats, and lenient decisions on prosecutorial strategies by U.S. state attorneys general for environmental enforcement).

The conclusion is inescapable. Cost savings cannot be justified as efficiencies by deriving the surplus theory from Pareto efficiency.[137] So, why does the notion that cost savings inherently signify efficiency persist in antitrust? As the next Section details, no other area of the law follows this practice.

V. ECONOMISTS DO NOT CONSIDER COST SAVINGS AS EFFICIENCIES IN ANALYZING LEGAL ISSUES OUTSIDE OF ANTITRUST

There is a large body of literature on law and economics, and economists have analyzed and debated legal doctrines in virtually every area of law. In all areas of law except antitrust, economists have adopted the definitions of efficiency suggested by Kaldor and Hicks, variously referred to as Kaldor-Hicks efficiency, the compensation principle, or potential Pareto efficiency. In his classic book *Economic Analysis of Law*, Richard Posner wrote:

> Because the conditions for Pareto superiority are almost never satisfied in the real world, yet economists talk quite a bit about efficiency, it is pretty clear that the operating definition of efficiency in economics is not Pareto superiority. When an economist says that free trade or competition or the control of pollution or some other policy or state of the world is efficient, nine times out of ten he means Kaldor-Hicks efficient, as shall this book.[138]

The leading case book on law and economics takes a similar approach: "In this book, an efficient allocation of resources is one that cannot be improved in either the Paretian or Kaldor-Hicks sense."[139] In other words, in law and economics, outside of the antitrust context, "efficiency" means "Kaldor-Hicks efficiency," whereas in the antitrust context, "efficiency" means "cost savings," which is completely different. Why the difference? Because, in antitrust, business interests have successfully

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137. However, this third assumption is not the only way to link the surplus theory of welfare to a social optimum. MCWG note, "Another way to justify the use of aggregate surplus as a welfare measure in the quasilinear model is as a measure of *potential Pareto improvement*." MAS-COLELL ET AL., *supra* note 64, at 334. This is because under the potential Pareto criterion, the social planner is indifferent to distribution, so there is no need to have a redistributing central authority. *See infra* Section V. To be precise, if the first two assumptions mentioned by Werden are satisfied, and if one adopts the potential Pareto criterion, then maximizing the surplus in one market (which requires minimizing costs) achieves a socially optimal allocation for the entire economy. *See* Werden, *Consumer Welfare*, *supra* note 116. The question to be answered is how desirable the potential Pareto criterion is.

138. RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 14 (4th ed. 1992).

139. DAVID BARNES & LYNN STOUT, CASES AND MATERIALS ON LAW AND ECONOMICS 17 (1992); *see also* MARK SEIDENFELD, MICROECONOMIC PREDICATES TO LAW AND ECONOMICS 49, 54 (1996) ("The first measure we will look at is that used by most microeconomists; it is called Pareto superiority. . . . Economists have come up with another, related measure of efficiency, called Kaldor-Hicks efficiency . . . ."); ROBIN PAUL MALLOY, LAW AND ECONOMICS: A COMPARATIVE APPROACH TO THEORY AND PRACTICE 38, 40 (1990) ("In discussion of efficiency, the concept of Pareto superiority or Pareto optimality are often referred to. . . . Two British economists, Nicholas Kaldor and John R. Hicks, came up with a different measure of efficiency."); DANIEL H. COLE & PETER Z. GROSSMAN, PRINCIPLES OF LAW AND ECONOMICS 10 (2004) ("Various *measures* of allocative efficiency are used, although two are most common: the Pareto criterion and the Kaldor-Hicks (or 'potential Pareto') criterion. Of these, the Pareto criterion is more often used in theoretical models, and the Kaldor-Hicks criterion is more useful in the real world, where it serves [as] the basis for cost-benefit analysis."); THOMAS J. MICELI, THE ECONOMIC APPROACH TO LAW 4–5 (3d ed. 2017) ("The basic definition of efficiency in economics is Pareto efficiency. . . . Economists [also employ] a relaxed notion of the Pareto criterion referred to as Potential Pareto efficiency, or Kaldor-Hicks efficiency.").

supplanted the notion of "efficiency" generally accepted in economics with their own notion of "efficiency."

But the solution is not as easy as simply restoring an economic definition of efficiency to antitrust analysis. The Kaldor and Hicks approaches have proven to be riddled with the same problems and inconsistencies that applied to the surplus approach. Because there are two criteria of value, EV (Hicks efficiency) and CV (Kaldor efficiency), the theory can lead to conflicting policy recommendations and reversals, which most textbooks render opaque by never revealing that Hicks efficiency and Kaldor efficiency are not the same. Moreover, the Kaldor-Hicks efficiencies, like the surplus approach, ignore distribution by assuming the marginal utility of money is constant and equal.[140] Additionally, unlike Pareto efficiency, under Kaldor-Hicks efficiency, the utility of losers and winners is compared, which requires assumptions that rule out perverse or other-regarding preferences. Yet, the law and economics textbooks almost uniformly fail to alert students to such issues.[141]

Kaldor and Hicks efficiencies attempt to link themselves to Pareto efficiency by use of the so-called compensation principle: a policy change is considered "Kaldor-Hicks efficient" if the winners—actual winners, in the Kaldor case, and potential winners, in the Hicks case—*could compensate* the losers and still retain some benefits.[142] If a policy is Kaldor-Hicks efficient, the "winners" could *potentially*

140. Marc Fleurbaey & Peter J. Hammond, *Interpersonally Comparable Utility*, *in* 2 HANDBOOK OF UTILITY THEORY 1187 (Salvador Barberà, Peter J. Hammond & Christian Seidl eds., 2004) ("At this stage, many economists of the so-called 'Chicago school', following Harberger (1971) in particular, succumb to the temptation of just adding different individuals' monetary measures. 'A dollar is a dollar', they might say, regardless of how deserving is the recipient. Implicitly, they attach equal value to the extra dollar a rich man will spend on a slightly better bottle of wine and to the dollar a poor woman needs to spend on life-saving medicine for her child. Of course, any such judgement is a value judgement, even an interpersonal comparison, which lacks scientific foundation. Thus, the 'surplus economists' who just add monetary measures, often of consumer surplus rather than individual welfare, make their own value judgements and their own interpersonal comparisons. Moreover, their comparisons not only lack scientific content, but most people—especially non-economists—also find them totally unacceptable from an ethical point of view. Surely it is better to avoid interpersonal comparisons altogether rather than make them in such a biased way." (footnote omitted)).

141. We have in a previous article detailed the definitions used in law and economics texts. See the Appendix to Glick & Lozada, *supra* note 100, at 94–114. An exception to our general statement that law and economics texts do not alert students to crucial caveats is RICHARD ZERBE, ECONOMIC EFFICIENCY IN LAW AND ECONOMICS (2001).

142. VISCUSI, VERNON & HARRINGTON, *supra* note 111, at 76. They explain:

> [I]f everyone is made better off by the change (or no one is made worse off, and at least one person is made better off), then the Pareto criterion would say that the change is "good." It is hard to argue with this criterion for evaluating public policies. The problem is that one is unlikely to find many "good" real-world policies. In most cases in the real world, at least some people will be harmed.
>
> A generally accepted alternative standard in applied microeconomics is the *compensation principle*, which is equivalent to choosing policies that yield the highest total *economic surplus*. The basic idea is that if the "winners" from any policy change can, in principle, compensate the "losers" so that everyone is better off, then it is a "good" change. Note that actual compensation of the losers is not required. If it were required, of course, it would satisfy the Pareto criterion.

Id.

compensate the "losers" so that the result would be a Pareto improvement, but the winners need not do so; hence the term "potential Pareto criterion."[143]

But the compensation principle does not carry the same ethical attractiveness as the Pareto principle, because there can be harm to some people from the policy change. For example, consider two policies: (A) allow a company to increase its air pollution, damaging the health of people downwind; (B) tax the increase in pollution and redistribute the tax proceeds to the pollution victims. Suppose that adopting "policy A together with policy B" is a Pareto improvement. Then an adherent of the compensation principle would not only support "policy A together with policy B," he must necessarily also support "policy A alone" (because policy B is "merely" redistributive). But what sense does it make to support policy A, because "policy A together with policy B" is a good policy? As philosopher and legal scholar Jules Coleman put it, what sense does it make to support a policy "in virtue of its potential to be something other than it is"?[144] In 1978, welfare economist John Chipman[145] and James Moore archly wrote that advocating policy A because policy A plus policy B would be good "is to wash one's hands of the responsibility for one's own actions."[146]

In sum, economists who study law outside of antitrust do not treat cost savings as efficiencies. They attempt to hew closer to Pareto efficiency by use of the potential Pareto or Kaldor-Hicks criteria. But this approach has been demonstrated to be hopelessly flawed and lacks the ethically redeeming qualities of Pareto efficiency. As a consequence, welfare economists have abandoned it as they have abandoned the surplus approach.

So, is antitrust analysis doomed to a future where outdated and defective measures of whether a proposed merger is beneficial continue to be applied in perpetuity? We think not, as other subdisciplines within economics offer potentially useful measures and mechanisms to evaluate whether a proposed merger will be a net benefit to human well-being.

VI. MODERN WELFARE ANALYSIS

Welfare economics today favors the social welfare function approach to measuring welfare. The social welfare function approach was first formulated more than three quarters of a century ago by Abram Bergson and Paul Samuelson.[147] The

143. Even here there are technical difficulties. Boadway and Bruce show that summing EV or CV may not always satisfy the compensation test. The relationship is complex. *See generally* BOADWAY & BRUCE, *supra* note 92, at 262–91.

144. Jules L. Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509, 546 n.62 (1980).

145. Chipman was a Fellow of the Econometric Society, of the American Academy of Arts and Sciences, and of the Guggenheim Foundation, a Distinguished Fellow of the American Economic Association, and an elected member of the National Academy of Science. *See John S. Chipman: Timeline of Selected Honors and Tributes*, UNIV. OF MINN., https://sites.google.com/umn.edu/chipmantimeline [https://perma.cc/9TQA-NNJL] (last visited Jan. 7, 2024).

146. John S. Chipman & James C. Moore, *The New Welfare Economics 1939–1974*, 19 INT'L ECON. REV. 547, 580 (1978).

147. Abram Bergson, *A Reformulation of Certain Aspects of Welfare Economics*, 52 Q.J. ECON. 310 (1938); *see also* PAUL SAMUELSON, FOUNDATIONS OF ECONOMIC ANALYSIS 219–29 (1947).

framework is now widely used by economists in many fields. Using social welfare function, policies can be ranked by their ability to increase human welfare. Like Pareto efficiency, social welfare function analysis considers the impact of policy outcomes (consequentialism) on human well-being (welfarism). In antitrust, we contend that the outdated surplus approach should be replaced by some aspects of the social welfare function approach, even though we do not believe that a full social welfare function analysis is feasible for an individual antitrust case.[148]

A social welfare function has at least three components (and a fourth, if uncertainty is factored into the analysis).[149] First, the identity of the individuals with standing must be established. Do all individuals affected by the policy count, or only a subset? As an example, consider whose welfare counts under the consumer welfare standard. The theory posits that only the welfare of consumers matters, even though there is no principled reason for this limitation. Most social welfare function analyses require that the welfare of all individuals affected by a policy change are taken into account.

Second, there must be a utility function, a method to convert measures of well-being into numbers for an individual. Economists often conceive of welfare as preference realization. Welfare measurement can be dollars derived from information concerning an individual's willingness to pay, as discussed in Part II.B. But welfare can also be understood as possession of an objective set of goods or opportunities that translate into subjective well-being.

Third, once welfare is measured, there must be a method to aggregate individual welfare numbers. As explained above, in antitrust economics today, the sum of surplus is used to aggregate welfare, which requires a constant and equal marginal utility of money (or marginal social welfare of surplus), so that a shift in surplus distribution produces no change in welfare.[150] A pure, unweighted sum of utility or welfare is called a utilitarian aggregation, because only the total counts. While the utilitarian approach is defended by economist John Harsanyi,[151] most moral philosophers (such as Ronald Dworkin, James Griffin, Will Kymlicka, G.A. Cohen, and Amartya Sen) have argued that some form of equality of welfare lies at the heart of justice and morality and therefore aggregation must incorporate weights that favor the worse off.[152] This way, policy may take account of inequality and recognize that it is unjust to allow persistent inequalities that are not related to the actions of individuals themselves.[153]

148. *See infra* Section VIII.

149. MATTHEW ADLER, MEASURING SOCIAL WELFARE: AN INTRODUCTION 4, 8–10 (2019).

150. In the case of a society of two persons, current antitrust economics treats social welfare as the sum of person 1's surplus, S_1, and person 2's surplus, S_2: $W = S_1 + S_2$. Then the marginal social welfare of person 1's surplus (which is $\partial W/\partial S_1$) is 1, and the marginal social welfare of person 2's surplus is 1. Clearly 1 is a "constant," and 1 is "equal" to 1, proving the claims of being "constant" and "equal." The extension to a society of more than two people is obvious.

151. Harsanyi, *supra* note 80, at 40–41.

152. *See generally* RONALD DWORKIN, SOVEREIGN VIRTUE: THE THEORY AND PRACTICE OF EQUALITY (2000); JAMES GRIFFIN, WELL BEING: ITS MEANING, MEASUREMENT, AND MORAL IMPORTANCE (1986); KYMLICKA, *supra* note 67, at 32–33 ; G.A. COHEN, ON THE CURRENCY OF EGALITARIAN JUSTICE AND OTHER ESSAYS IN POLITICAL PHILOSOPHY (2011); Amartya Sen, *Utilitarianism and Welfarism*, 76 J. PHIL. 463 (1979).

153. *See, e.g.*, KASPER LIPPERT-RASMUSSEN, LUCK EGALITARIANISM (2016).

This approach is referred to as prioritarian.[154] The standard assumption adopted by economists to capture sensitivity to the distribution of well-being is the Pigou-Dalton axiom, which states that "a pure, gap-diminishing transfer of well-being from a better-off [individual] to a worse-off individual, with everyone else unaffected, is an ethical improvement."[155] We note that the surplus approach violates Pigou-Dalton and, as a result, is in tension with modern welfare scholarship.[156]

Critical to our proposal for reform of antitrust is the measurement of welfare. In our discussion of the surplus approach, we highlighted the numerous defects inherent in measuring welfare by observing willingness to pay.[157] Modern welfare economics now offers an alternative.[158] For the last fifty years, scholars have been developing the subjective well-being approach, in which comprehensive surveys ask subjects some variation of the question, "Overall, how satisfied are you with your life these days?"[159] Individuals answer the question on a scale from zero to ten. Economist Bruno Frey reports that subjective happiness studies have been performed in eighty countries, comprising over 80% of the world's population, at various periods of time.[160] The results of these numerous surveys have been verified by high correlations of the answers across the same questions, over time.[161] Scholars have used a variety of comparisons to verify survey answers: comparing survey responses with objective measures of brain activity, with reports by third parties familiar with the survey subjects, with the predictive power of subject's answers, and with other factors.[162]

154. *See id.* at 29–30; COHEN, *supra* note 152, at 70.

155. ADLER, *supra* note 149, at 95.

156. There is a lively debate on the meaning of equality of persons. Most philosophers stress equality of opportunity because of respect for the freedom of humans to select how much effort to expend to achieve outcomes. Dworkin and John Rawls focused on the distribution of objective goods or resources. *See generally* DWORKIN, *supra* note 152. The problem with these approaches is that people can derive different amounts of welfare from the same resources. G.A. Cohen argued in favor of a type of equality of opportunity to achieve welfare. *See generally* COHEN, *supra* note 152. Sen's capability approach is a middle ground. Sen focused on equality of actual capability to achieve an outcome. He is interested in what resources do for persons with respect to ability to function or occupation. Sen's approach can be justified not only by equality but by the value of actual freedom of individuals. *See generally* Sen, *supra* note 152.

157. *See supra* Part II.B.4.

158. *See generally* STIGLITZ ET AL., *supra* note 87; FREY, *supra* note 87; MARC FLEURBAEY & DIDIER BLANCHET, BEYOND GDP MEASURING WELFARE AND ASSESSING SUSTAINABILITY (2013); ANIELSKI, *supra* note 87; JACHIM WEIMANN, ANDREAS KNABE & RONNIE SCHOB, MEASURING HAPPINESS: THE ECONOMICS OF WELL-BEING (2015); KAHNEMAN ET AL., *supra* note 87.

159. U.N., WORLD HAPPINESS REPORT 17 (John F. Helliwell et al. eds., 2023), https://happiness-report.s3.amazonaws.com/2023/WHR+23.pdf [https://perma.cc/T5Z7-GXRW]. There are several versions of this question. For example, the Cantril ladder question asks:

> Please imagine a ladder, with steps numbered from 0 at the bottom to 10 at the top. The top of the ladder represents the best possible life for you and the bottom of the ladder represents the worst possible life for you. On which step of the ladder would you say you personally feel you stand at this time?

LAYARD & DE NEVE, *supra* note 55, at 19. Gallup uses this question as well. *See Understanding How Gallup Uses the Cantril Scale*, GALLUP, https://news.gallup.com/poll/122453/understanding-gallup-uses-cantril-scale.aspx [https://perma.cc/Q2PR-KP24].

160. FREY, *supra* note 87, at 20.

161. *Id.* at 20–24.

162. LAYARD & DE NEVE, *supra* note 55, at 18–23.

Scholars then use objective and subjective data, as well as social science research, to determine the factors that explain well-being.[163]

To take one example (using a Congressional antitrust goal), living in a democratic country has a positive impact on well-being.[164] Objective data from the World Bank, the Economist Intelligence Unit, and the Varieties of Democracy project can be used to study this relationship. Moreover, the relationship can be confirmed by other economic research. For example, Daron Acemoglu and James Robinson concluded that inclusive economic and political institutions are the key common element in successful economies, and they are essential to prosperity and development.[165] Similarly, income inequality lowers well-being.[166] Again, epidemiological evidence supports this conclusion, as income inequality correlates with greater drug use, violence, mental illness, and other problems.[167]

An enormous amount of research has focused on the determinants of well-being. Large-scale analyses by international organizations, including the European Union, the United Nations, the World Bank, the Organisation for Economic Co-operation and Development, and many governments have assembled similar sets of indicators that materially impact well-being either positively or negatively.[168] For example, the Eurostat expert group converged on nine critical well-being factors: (1) material living conditions (income), (2) productive activity (unemployment and quality of work), (3) health, (4) education, (5) leisure and social interactions, (6) economic security and personal safety (poverty and crime), (7) governance and basic rights (democracy and good government), (8) natural and living environment (pollution), and (9) overall life experience.[169] Joseph Stiglitz, Amartya Sen, and Jean-Paul Fitoussi and the World

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163. *See, e.g.*, Des Gasper, *Subjective and Objective Well-Being in Relation to Economic Inputs: Puzzles and Responses*, 63 REV. SOC. ECON. 177 (2005); Filomena Maggino, *Methodologies To Integrate Subjective and Objective Information To Build Well-Being Indicators*, UNIVERSITA DEGLI STUDI FIRENZE (2009), https://flore.unifi.it/retrieve/handle/2158/370602/11439/maggino_-_paper.pdf [https://perma.cc/N9C6-D3C9].

164. *See, e.g.*, David Dorn, Justina A.V. Fischer, Gehhard Kirchgässner & Alfonso Sousa-Poza, *Is It Culture or Democracy? The Impact of Democracy and Culture on Happiness*, 82 SOC. INDICATORS RSCH. 505, 505, 512 (2007) ("[A] significant positive relationship between democracy and happiness [exists] even when controlling for income and culture measured by language and religion."); FREY, *supra* note 87, at 64 ("Overall, these results suggest that individuals living in countries with more extensive democratic institutions feel happier with their lives according to their own evaluation than individuals in more authoritarian countries."); Michael O. Allen, Kenneth Scheve & David Stasavage, *Democracy, Inequality and Antitrust*, SSRN (Feb. 3, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4358176 [https://perma.cc/G7YS-R6H7].

165. DARON ACEMOGLU & JAMES ROBINSON, WHY NATIONS FAIL: THE ORIGINS OF POWER, PROSPERITY AND POVERTY 43–44 (2012).

166. Shigehiro Oishi, Selin Kesebir & Ed Diener, *Income Inequality and Happiness*, 22 PSYCH. SCI. 1095, 1099 (2012) (showing that U.S. happiness levels are negatively related to inequality).

167. *See generally* RICHARD WILKINSON & KATE PICKETT, THE SPIRIT LEVEL: WHY GREATER EQUALITY MAKES SOCIETY STRONGER (2010) (showing income inequality undermines community and correlates with status anxiety, mental illness, greater drug use, more violence, and lower life expectancy).

168. *See* generally EUROSTAT, EU, FINAL REPORT OF THE EXPERT GROUP ON QUALITY OF LIFE INDICATORS (2017); U.N., *supra* note 159; WORLD BANK, THE CHANGING WEALTH OF NATIONS: MEASURING SUSTAINABLE DEVELOPMENT IN THE NEW MILLENNIUM, (2011); OECD, GUIDELINES ON MEASURING SUBJECTIVE WELL-BEING (2013).

169. EUROSTAT, *supra* note 168, at 8. These factors are multidimensional.

Happiness Report have formulated similar factors.[170] Psychologists also report results consistent with the economic studies.[171]

Finally, moral philosophers have offered consistent lists of well-being components—Martha Nussbaum, George Sher, James Griffin, and Richard Kraut, for example, have discussed key factors of well-being.[172] Critically, these quality-of-life factors are related to many of the New-Brandeisian alternative goals for antitrust: inequality,[173] unemployment and quality of work,[174] democracy,[175] protection of small business,[176] macroeconomic growth,[177] and sustainability.[178]

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170. Stiglitz, Sen, and Fitoussi list eight factors: material living standards, health, education, personal activities including work, political voice and governance, social connections and relationships, the environment, and insecurity. STIGLITZ ET AL., *supra* note 87, at 15. The U.N. World Happiness Report lists physical and mental health; human relationships; income and employment; character virtues, including pro-sociality and trust; social support; personal freedom; lack of corruption; and effective government. U.N., *supra* note 159, at 19.

171. Michael Argle, *Causes and Correlates of Happiness*, *in* WELL-BEING: THE FOUNDATIONS OF HEDONIC PSYCHOLOGY, *supra* note 87, at 353, 356–57.

172. MATTHEW ADLER, WELL-BEING AND FAIR DISTRIBUTION: BEYOND COST-BENEFIT ANALYSIS 166–67 (2012) ("Nussbaum argues that the central human capabilities are: life; bodily health; bodily integrity; the senses, imagination, and thought; emotions; practical reason; affiliation; other species; play; and control over one's environment. Sher endorses a list suggested by Parfit: moral goodness; rational activity; the development of one's abilities; having children and being a good parent; knowledge; and the awareness of true beauty. Griffin's [list] is: accomplishment; 'the components of human existence' (roughly, autonomy and physical integrity); understanding; enjoyment; deep personal relations. Kraut argues that the good for a human being consists of 'the exercise of cognitive, social, affective, and physical skills.'" (first quoting JAMES GRIFFIN, VALUE JUDGMENT: IMPROVING OUR ETHICAL BELIEFS 29 (1996); and then quoting RICHARD KRAUT, WHAT IS GOOD AND WHY: THE ETHICS OF WELL-BEING 145 (2007))).

173. *See* Lina Kahn & Sandeep Vaheesan, *Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents*, 11 HARV. L. & POL'Y REV. 235, 246–47 (2017); Jonathan Baker & Steven Salop, *Antitrust, Competition Policy, and Inequality*, 104 GEO. L.J. ONLINE 1, 13–14 (2015), https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?params=/context/facpub/article/2474/&path_info=Baker_Salop_Antitrust_Competition_Policy_and_Inequality.pdf [https://perma.cc/CL3C-SBGE].

174. *See* POSNER, *supra* note 49, at 19–23; Stucke, *Looking at Monopsony*, *supra* note 49, at 1527–29.

175. Sanjukta Paul, *Recovering the Moral Economy Foundations of the Sherman Act*, 131 YALE L.J. 175, 252–53 (2021); *see also* Stephen Martin, *Dispersion of Power as an Economic Goal of Antitrust Policy* 15 n.21 (Krannert Sch. Mgmt. Purdue U., Working Paper No. 1285, 2016) (quoting N. Pac. Ry. Co. v. United States, 356 U.S. 1, 4 (1958)), https://business.purdue.edu/research/working-papers-series/2016/Martin-Dispersion%20of%20Power%20as%20an%20Economic%20Goal%20of%20Antitrust%20Policy.pdf [https://perma.cc/XL3Y-QKGX]; Harlan M. Blake & William K. Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 COLUM. L. REV. 422, 422 (1965).

176. *See* Sandeep Vaheesan, *The Evolving Populisms of Antitrust*, 93 NEB. L. REV. 370, 427 (2014) (noting purpose of antitrust laws is protecting non-elite groups, like small businesses and consumers, from powerful corporations); Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 104 (1982) ("[T]he congressional intent to assist small businesses can be interpreted as promoting distributive, rather than efficiency, considerations."). *See generally* John J. Flynn, *"Reaganomics" and Antitrust Enforcement: A Jurisprudential Critique*, 1983 UTAH L. REV. 269. Economic research shows that self-employed persons typically are more satisfied with their jobs than employees at large corporations. *Cf.* Sana El Harbi & Giles Grolleau, *Does Self-Employment Contribute To National Happiness?*, 41 J. SOCIO-ECON. 670 (2012). *See generally* Matthias Benz & Bruno S. Frey, *Being Independent Is a Great Thing: Subjective Evaluations of Self-Employment and Hierarchy*, 75 ECONOMICA 362 (2008); Stefan Schneck, *Why the Self-Employed Are Happier: Evidence from 25 European Countries*, 67 J. BUS. RSCH. 1043 (2014).

In place of the outdated antitrust "efficiency" narrative, premised on cost savings contributing to welfare, we propose that antitrust policy should consider factors that have been shown to impact well-being and that can be influenced by antitrust policy. Before we discuss how to do this, however, we first must ask, who should select the well-being factors that antitrust policy should address? The answer is self-evident: antitrust policy should be guided by the policies Congress had in mind when it enacted the antitrust statutes.

VII. CONGRESSIONAL GOALS AND EFFICIENCY

Sen has emphasized the importance of the process by which welfare policy goals are selected and has asserted that the manner in which goals are selected and who participates should be a collective decision.[179] Antitrust is uniquely situated to determine its goals because, while the courts decide what the law is, courts generally share the premise of adhering to the congressionally intended objectives of the law.[180] Courts interpret the statutes "to give effect to the intent of Congress."[181] In this Section we show, first, that Congress never mandated that efficiencies, let alone cost savings, would be a defense to an otherwise anticompetitive merger and, second, that Congress made clear that its goals for limiting the concentration of economic power included (1) protecting political democracy, (2) protecting small businesses and opportunities for entrepreneurship, and (3) preventing adverse income transfers.

There is a virtual consensus among antitrust scholars that efficiency is not a stated goal of congressional merger regulation.[182] As Herbert Hovenkamp summarized:

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177. *See* Michael E. Porter, *Competition and Antitrust: A Productivity Based Approach*, 46 ANTITRUST BULL. 919, 920 (2001).

178. *See, e.g.*, Simon Homes & Michelle Meagher, *A Sustainable Future: How Can Control of Monopoly Power Play a Part* (pts. 1–3), 44 EUR. COMPETITION L. REV., 16, 61, 148 (2023).

179. Antoinette Baujard & Muriel Gilardone, *Sen Is Not a Capability Theorist*, 24 J. ECON. METHODOLOGY 1, 9 (2017).

180. Moreover, efficiencies are not mentioned in the statutory language of any of the antitrust statutes. *See, e.g.*, The Clayton Act, Pub. L. No. 63-212, 38 Stat. 730 (1914) (codified at 15 U.S.C. §§ 12–27); Celler-Kefauver Anti-Merger Act, Pub. L. No. 81-899, 64 Stat. 1125 (1950) (amending 15 U.S.C. § 18, 21). In one instance, Congress did provide an efficiency defense in an antitrust law. *See* Robinson-Patman Act, Pub. L. No. 74-692, 49 Stat. 1526 (1936) (codified as amended at 15 U.S.C. § 13).

181. United States v. Am. Trucking Ass'ns, Inc., 310 U.S. 534, 542 (1940). *See generally* CONG. RSCH. SERV., STATUTORY INTERPRETATION: THEORIES, TOOLS, AND TRENDS (2023), https://crsreports.congress.gov/product/pdf/R/R45153 [https://perma.cc/2L3U-HUVD].

182. Nor were efficiencies a congressional goal in passage of the Sherman Act. *See* 21 CONG. REC. 2462 (1890). Senator Sherman himself recognized that the benefits of cost savings are rarely, if ever, passed on to consumers. *Id.* at 2460. He said: "It is sometimes said of these combinations that they reduce prices to the consumer by better methods of production, but all experience shows that this saving of cost goes to the pockets of the producer." *Id.* Similarly, Representative William E. Mason rejected the notion of cost savings as antitrust absolution: "Some say that the trusts have made products cheaper, have reduced prices; but if the price of oil, for instance, were reduced to 1 cent a barrel it would not right the wrong done to the people of this country by the 'trusts' which have destroyed legitimate competition and driven honest men from legitimate business enterprises." *Id.* at 4100. Indeed, Senator Sherman was not impressed with the notion that the merged firm could lower prices. *See id.* at 2457. In fact, he contemplated that a firm might do so for a time only in an effort to control the market: "It can control the market, *raise or lower prices*, as will best promote its selfish interests . . . ." *Id.* (emphasis added).

> No one, it appears, has even attempted to argue that Congress had "efficiency" in mind when it passed the Robinson-Patman Act in 1936, or the Celler-Kefauver amendments to Section 7 of the Clayton Act in 1950. . . . Likewise, no compelling case has been made that efficiency considerations dominated in the passage of the Clayton Act itself.[183]

In one example from the Congressional debates around the Celler-Kefauver Act, New York Representative Emanuel Celler, an amendment sponsor, stated:

> I deprecate the idea that efficiency and lower prices only come with bigness. We now know that in many lines the middle-sized concerns are either more efficient than the big ones, or else they are of no positive difference. And lower prices do not always accompany bigness, nor should it be essential for colossal concerns to grow bigger for purposes of research.[184]

At least three Supreme Court opinions have clearly stated that efficiencies are not a defense to a merger that substantially harms competition under Section 7 of the Clayton Act.[185]

In passing the amendment to Section 7, Congress was not concerned with efficiency. Instead it stated plainly that it sought to prevent aggregation of economic and political power in order to preserve democracy, promote small businesses and local control, and avoid the impact of adverse income redistribution.[186]

A. Congress Wanted To Prevent Concentrated Markets To Preserve Democracy

During the Celler-Kefauver Act debates, Congress made clear that it was concerned with economic concentration because of its impact on political democracy, among other reasons.[187] Probably one of the clearest statements of this traditional

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183. Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213, 250 (1985).

184. *Corporate Mergers and Acquisitions: Hearing on H.R. 2734 Before the Subcomm. of the Comm. on the Judiciary*, 81st Cong. 64 (1950) [hereinafter *Corporate Mergers and Acquisitions Hearing*] (statement of Rep. Emanuel Celler). Representative Celler continues, "Du Pont, with all of its efficient research, did not have to grow even bigger by acquiring controlling interest in General Motors and United States Rubber, and as a result eliminate many independents and horribly weakened those that survived. But the Du Ponts did that by the loophole in section 7 and section 12 of the Clayton Act." *Id.*

185. Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962) ("Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization."); United States v. Phila. Nat'l Bank, 374 U.S. 321, 370–71 (1963) ("[I]t is surely the case that competition is our fundamental national economic policy, offering as it does the only alternative to the cartelization or governmental regimentation of large portions of the economy."); FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967) ("Possible economies [from a merger] cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.").

186. Congressional support for these goals was expressed during the debates leading to the passage of the Sherman Act, the Clayton Act, and the Federal Trade Commission Act. *See* Mark Glick & Darren Bush, *Breaking Up Consumer Welfare's Antitrust Policy Monopoly*, 56 SUFFOLK U. L. REV. 201, 208–09 (2023); Zephyr Teachout & Lina Khan, *Market Structure and Political Law: A Taxonomy of Power*, 9 DUKE J. CONST. LAW & PUB. POL'Y 37, 62–63 (2014); Robert H. Lande & Sandeep Vaheesan, *Preventing the Curse of Bigness Through Conglomerate Merger Legislation*, 52 ARIZ. ST. L.J. 75, 82–85 (2020); *see also Corporate Mergers and Acquisitions Hearing*, *supra* note 184.

187. Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1064 (1979) ("A striking feature of the legislative history of amended section 7 was the widely-shared perception of danger to the political well-being of the country and its citizens stemming from the merger movement."); Daniel A.

antitrust goal was Justice Douglas's dissent in the 1948 Columbia Steel merger case, a case brought by the government under the Sherman Act:

> Power that controls the economy should be in the hands of elected representatives of the people, not in the hands of an industrial oligarchy. Industrial power should be decentralized. It should be scattered into many hands so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability of a few self-appointed men. . . . [The Sherman Act] is founded on a theory of hostility to the concentration in private hands of power so great that only a government of the people should have it.[188]

Only a few years later, Congress debated the amendments to Section 7 of the Clayton Act (the Celler-Kefauver Act). At the end of World War II, it was widely held that concentration of industry in Germany and Italy had led to the rise of fascism and the undermining of democracy, and this was one of the main motivations for limiting concentration in the United States. In this vein Tennessee Senator Carey Estes Kefauver stated:

> I am not an alarmist, but the history of what has taken place in other nations where mergers and concentrations have placed economic control in the hands of very few people is too clear to pass over easily. A point is eventually reached, and we are rapidly reaching that point in this country, where the public steps in to take over when concentration and monopoly gain too much power. The taking over by the public through its government always follows one or two methods and has one or two political results. It either results in a Fascist state or the nationalization of industries and thereafter a Socialist or Communist state.[189]

Wyoming Senator Joseph O'Mahoney likewise argued that such imbalance in ownership and wealth creates conditions for a totalitarian state:

> Unless we attempt to stop it, unless we will succeed in stopping it, the inevitable result will be a terrific drive toward a totalitarian government. I can see no other alternative. Either we maintain a free economy by preventing monopolistic mergers and by creating incentives for the investment of private capital in competitive enterprises, or the system of competition is bound to fail. It has failed everywhere else.[190]

Preserving democracy was a key objective of Congress's efforts to limit concentration through merger regulation.

Crane, *Antitrust and Democracy: A Case Study from German Fascism* 4–5 (U. Mich. L. & Econ. Research Paper, No. 18-009, 2018), https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1266&context=law_econ_current [https://perma.cc/EU2W-X2JH] ("Celler and Kefauver's floor speeches reflected a broader concern of the U.S. Congress that industrial concentration facilitated the incubation of totalitarianism and threatened democracy.").

188. United States v. Columbia Steel Co., 334 U.S. 495, 536 (1948).

189. Lande & Vaheesan, *supra* note 186, at 84 (quoting 96 CONG. REC. 16452 (1950) (statement of Sen. Carey Estes Kefauver)). Lande and Sandeep Vaheesan assemble numerous statements made during the 1950 amendment's congressional debate with similar import. *See id.* at 84 n.37.

190. *Corporate Mergers and Acquisitions Hearing*, *supra* note 184, at 8–9 (statement of Sen. Joseph O'Mahoney).

B. Congress Wanted To Protect Small Business

Protection of small business was another traditional goal of antitrust enforcement,[191] and Section 7 of the Clayton Act is no exception. In *Brown Shoe Co. v. United States*, the Supreme Court examined the legislative history of the amendment to Section 7 of the Clayton Act:

> It is competition, not competitors, which the [Clayton] Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets.[192]

As the Court made clear, values other than cost savings and even lower prices were important goals of the amended Section 7 of the Clayton Act.[193]

C. Congress Was Also Concerned About Distribution of Income and Labor

The case that Congress was concerned about distribution of income has already been made by Bob Lande. In his 1982 article, Lande assembled the evidence that Congress has been concerned about higher prices because they transfer wealth from consumers to corporations.[194] There are also numerous explicit statements of Congress's concern that concentration adversely redistributes wealth. Ohio Senator John Sherman was concerned about "the inequality of condition, of wealth, and opportunity that has grown within a single generation out of the concentration of capital into vast combinations to control production and trade and break down competition."[195] Similarly, Mississippi Senator James George stated that trusts "have extorted their ill-gotten gains from the poor and then used the money thus obtained to complete the ruin of the people."[196]

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191. Wesley A. Cann, Jr., *Section 7 of the Clayton Act and the Pursuit of Economic "Objectivity": Is There Any Role for Social and Political Values in Merger Policy?*, 60 NOTRE DAME L. REV. 273, 273 (1985) ("Congress [when passing the Celler-Kefauver Act] expressed concern for small businesses and for local communities in which these businesses had played such an important role."). *See generally* STACY MITCHELL & RON KNOX, INST. FOR LOC. SELF-RELIANCE, ROLLING BACK CORPORATE CONCENTRATION: HOW NEW FEDERAL ANTIMERGER GUIDELINES CAN RESTORE COMPETITION AND BUILD LOCAL POWER (2022) (discussing the legislative history of the Clayton Act and the economic benefits of small business). Two of the authors have documented the numerous congressional and judicial statements demonstrating that a primary goal of all of the antitrust statutes has been the protection of small business. *See* Glick & Bush, *supra* note 186, at 216–18.

192. 370 U.S. 294, 344 (1962).

193. AMY KLOBUCHAR, ANTITRUST: TAKING ON MONOPOLY POWER FROM THE GILDED AGE TO THE DIGITAL AGE 342–43 (2021) ("For decades (indeed, since the country's founding), small businesses have been the engine of America's economy and of job growth. We need to make sure that small businesses continue to power economic growth. . . . In what I see as a warning sign, however, a December 2018 report measuring the contribution of small businesses to the American economy determined that the small-business share of GDP declined from 48 percent in 1998 to 43.5 percent in 2014.").

194. *See generally* Lande, *supra* note 176.

195. David Millon, *The Sherman Act and the Balance of Power*, 61 S. CAL. L. REV. 1219, 1277 (1988) (quoting 21 CONG REC. 2460 (1890) (statement of Sen. John Sherman)).

196. 21 CONG. REC. 1768 (1890) (statement of Sen. James George).

The congressional debates preceding passage of the Federal Trade Commission Act and the Clayton Act voiced concerns about distribution of income. Oklahoma Representative Dick Morgan identified among the purposes for creation of the FTC, "[t]o minimize the power of the large industrial corporation to concentrate wealth, . . . to maximize its power as an agency for the equitable distribution of wealth," "[t]o allay public suspicion and distrust, remove prejudice and secure the people from unjust tribute levied by monopolistic corporations."[197] He further specifically justified the introduction of the Federal Trade Commission Act to "make these corporations better instruments for the equitable distribution of wealth."[198]

Importantly, during the Cellar-Kefauver Act debates, Senator O'Mahoney linked together the concerns regarding income distribution, labor, and democracy:

> We have been creating a proletariat in the United States. We have a collectivist business organization. That is why it comes about that 113 manufacturing concerns own 46 percent of the manufacturing assets. It also comes about that eight-tenths of 1 percent of the employers of the United States employ 52 percent of the workers. If this concentration continues, it will be utterly impossible to prevent the continued expansion of the powers of the Federal Government.[199]

Congress and the Supreme Court, in their roles in our democratic decision-making process, have determined that preservation of democracy, protection of small business, and prevention of adverse income redistribution by concentration are social welfare goals of the antitrust acts. We believe these values can be incorporated into judicial analysis of mergers and the New Merger Guidelines that direct agency merger analysis. The next Section explains how this can be accomplished.

VIII. HOW WELFARE CONSIDERATIONS CAN BE INTEGRATED INTO THE MERGER GUIDELINES

This Section describes how congressional values can be integrated into the Merger Guidelines. The first step is to do away with the Merger Guidelines' use of a concentration screen to exempt mergers from agency review based on the dubious presumption that mergers below a certain concentration level do not harm competition. That screen is premised on the presumed existence of ubiquitous cost savings resulting from all mergers. However, as shown in the Appendix, there is no evidence or support for such an assumption. This approach should be replaced with an evidence-based sliding scale of concentration thresholds that is grounded in a determination of whether the merger at issue presents a danger of harm to the congressional objectives of preservation of democracy, prevention of harm to small business, or causation of adverse distributional effects.

Second, the efficiency rebuttal section in the New Merger Guidelines should be dropped. This rebuttal section is flawed for four reasons: (1) the rebuttal can only establish that cost savings counteract price increases when the dangers of high

197. 51 CONG. REC. 8854 (1914) (statement of Rep. Dick Morgan).

198. *Id.* at 8855.

199. *Corporate Mergers and Acquisitions Hearing*, *supra* note 184, at 8–9 (statement of Sen. O'Mahoney).

concentration are broader than higher prices; (2) there is no evidence in case law or the empirical economic research that mergers reduce prices through cost savings; (3) few, if any, cost savings are merger-specific; and (4) most future cost savings are speculative.

A. Congressional Goals Can Be Integrated into Merger Analysis by Replacing the Current Fixed Concentration Screen with a Variable Concentration Screen

Exempting mergers below a certain concentration threshold would be justified only if it were true that all mergers generate significant efficiencies. Yet, economists agree that such a presumption simply does not hold.[200] To the contrary, even small increases in concentration are known to raise prices to consumers, and therefore cause competitive harm. Accordingly, if we are to allow any merger, the decision must be based on proven, not presumed, offsetting benefits.[201]

The unfounded assumption that all mergers generate cost saving benefits has been a staple of the Merger Guidelines for some time. The 1984 Merger Guidelines express this assumption: "The primary benefit of mergers to the economy is their efficiency-enhancing potential, which can increase the competitiveness of firms and result in lower prices to consumers."[202] And, under the New Merger Guidelines, mergers in markets where concentration is below 1000 on the Herfindahl–Hirschman Index (HHI) and the change is less than 100 HHI,[203] escape antitrust scrutiny. The reason for this approach, which has been part of every version of the Merger Guidelines, is that mergers are presumed to lower costs and, as a result, provide some benefit to consumers.

Frederick Warren-Boulton, an economist in the Antitrust Division of the DOJ, made this presumption clear as far back as 1985:

> I should preface this discussion by saying that the very existence of "safe harbor" Herfindahls in the *Guidelines* already implies a "standard deduction" for efficiencies. Such a standard deduction is implicit in a policy that allows mergers that increase concentration to some extent, even without a showing of any efficiency gains. Alternatively, the parties can choose to itemize efficiencies, rather than just take the standard deduction, by presenting an explicit efficiency defense.[204]

200. Nancy L. Rose & Jonathan Sallet, *The Dichotomous Treatment of Efficiencies in Horizontal Mergers: Too Much? Too Little? Getting It Right*, 168 U. PA. L. REV. 1941, 1953–55 (2020) (making this point and identifying the many others who have made a similar point).

201. Joseph Farrell & Carl Shapiro, *Horizontal Mergers: An Equilibrium Analysis*, 80 AM. ECON. REV. 107, 122 (1990) ("[A]ny merger that generates no synergies . . . raises price.").

202. 1984 MERGER GUIDELINES, *supra* note 16, § 3.5, at 23.

203. The HHI "is defined as the sum of the squares of the market shares; it is small when there are many small firms and grows larger as the market becomes more concentrated, reaching 10,000 in a market with a single firm." 2023 MERGER GUIDELINES, *supra* note 32, § 2.1, at 6.

204. Frederick R. Warren-Boulton, *Merger Policy and Enforcement at the Antitrust Division: The Economist's View*, 54 ANTITRUST L.J. 109, 112 (1985); Louis Kaplow, *Efficiencies in Merger Analysis*, 83 ANTITRUST L.J. 557, 608 (2021) ("Efficiencies are ever-present but difficult and costly to analyze in merger investigations. Therefore, it makes sense to impute some degree of efficiencies—the efficiency credit—automatically . . . . Moreover, this credit is fairly large, so that most cases are resolved in this manner

Yet, as we have demonstrated above, Congress never contemplated a safe harbor for mergers that result in cost savings.[205] Quite to the contrary, Congress dismissed cost savings as a proper goal of merger control and instead premised Section 7 of the Clayton Act on preventing a rise in concentration to further the goals of preserving democracy, protecting small business, and avoiding adverse income redistribution. To implement congressional intent requires that the concentration screen be tied to an assessment of the dangers a particular proposed merger poses to these three central objectives. In the case of a merger that could impact democracy, this would likely require that the concentration threshold for challenge be lowered or raised based on two factors: (1) the size of the parties, and (2) the market at issue.

The size of a corporation is not a factor in the Merger Guidelines except to the extent that there is an increase in concentration in a particular market. There is nothing to prevent a merger between Exxon and Walmart, for example, if there are no product overlaps. However, such a company would wield enormous political clout. In general, as analyzed by Lande and Vaheesan, the size of the parties will have a marked impact on the danger posed to democracy by a merger. As Lande and Vaheesan show, mergers could continue with a screen of 1000 HHI until only ten firms remained in the United States, centralizing enormous political power.[206] It makes sense, therefore, to apply lower concentration thresholds for large firms than for smaller firms.

Different markets also present unique dangers to congressional goals. Media markets, for example, can have important implications for the democratic process, and there are good reasons to maintain deconcentrated markets in television, radio, newspapers, and social media.

Other factors would determine when markets are more susceptible to causing adverse effects on income distribution. For example, perhaps markets providing goods and services disproportionately frequented by lower-income Americans should require greater scrutiny and lower concentration triggers than, for example, luxury markets. On the other hand, markets for harmful substances, like cigarettes, might justifiably receive a higher concentration threshold because higher prices will reduce use by the public. Markets traditionally dominated by small business, or markets where local control is important or where a trend toward destruction of small business is evident, should also receive heightened antitrust scrutiny.

While we do not offer a comprehensive concentration approach here, we do believe that the suggested mechanism is a workable method for integrating congressional goals into merger enforcement.

B. *The Present Efficiency Rebuttal Section of the Merger Guidelines Should Be Abandoned*

Independent of our proposal in Part A, we believe that there are persuasive reasons why the rebuttal efficiency section in the New Merger Guidelines should be jettisoned. There are at least four reasons why cost savings should not be considered as

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[by the safe harbor].”); Herbert Hovenkamp, *Antitrust Balancing*, 12 N.Y.U. J.L. & BUS. 369, 379–80 (2016) (providing citations); Farrell & Shapiro, *supra* note 201, at 122.

205. *See supra* Section VII.

206. Lande & Vaheesan, *supra* note 186, at 76.

rebuttal evidence to a merger that increases concentration beyond the Merger Guidelines' thresholds.[207] First, the efficiency rebuttal applies when the merging parties demonstrate that the merger will result in merger-specific and verifiable cost savings that are passed on to consumers in the form of a lower price. Lowering prices should not be a rebuttal to an increase in concentration above the allowable limits, because the adverse impact of concentration is not limited to price. Increases in concentration can reduce quality and innovation and, thus, still adversely impact congressional goals. Compare the efficiency rebuttal with the Merger Guidelines' entry rebuttal.[208] If the merger parties can demonstrate timely, likely, and sufficient entry, they may successfully rebut an increase in concentration. But this is because new entry actually lowers concentration. A merger's claimed cost savings provides no comparable assurance; rather, it leaves the high levels of concentration in place and does not mitigate any other effect of concentration.

Second, we have been unable to identify any empirical study in which a merger led to cost savings that were sufficient to offset a predicted anticompetitive price increase. Moreover, defendants have rarely demonstrated that merger cost savings are actually passed on to consumers.[209] As one district court recently stated, "The Court is

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207. BORK, *supra* note 7, at 127 ("Passably accurate measurement of the actual situation [including an estimate of so-called efficiencies and deadweight loss] is not even a theoretical possibility; much less is there any hope of arriving at a correct estimate of the hypothetical situation."); *see also* RICHARD POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE, 112–13 (1976) ("I would not allow a generalized defense of efficiency. Not only is the measurement of efficiency (whether based on economics of scale, superior management, or whatever) an intractable subject for litigation; but an estimate of a challenged merger's cost savings could not be utilized in determining the total economic effect of the merger unless an estimate was also made of the monopoly costs of the merger . . . ."); Fisher & Lande, *supra* note 14, at 1656. ("Merger policy must recognize the limited ability of courts and the Commission to assess efficiencies accurately.").

208. "To evaluate this rebuttal evidence, the Agencies assess whether entry induced by the merger would be 'timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.'" 2023 MERGER GUIDELINES, *supra* note 32, § 3.2 (quoting FTC v. Sanford Health, 926 F.3d 959, 965 (8th Cir. 2019)).

209. In *New York v. Deutsche Telekom AG*, the court considered evidence of merger efficiencies. However, the court cautioned:

> [T]he Court concludes that Defendants' proposed efficiencies are cognizable and increase the likelihood that the Proposed Merger would enhance competition in the relevant markets to the benefit of all consumers. However, mindful of the uncertainty in the state of the law regarding efficiencies and Plaintiff States' pertinent criticisms, the Court stresses that the Proposed Merger efficiencies it has recognized constitute just one of many factors that it considers and do not alone possess dispositive weight in this inquiry.

439 F. Supp. 3d 179, 217 (S.D.N.Y. 2020).

In *FTC v. Butterworth Health Corp.*, the court considered the efficiencies claim as being passed on to consumers:

> [T]he Court is persuaded that the proposed merger would result in significant efficiencies, in the form of capital expenditure avoidance and operating efficiencies, totaling in excess of $ 100 million. This is, by any account, a substantial amount, and represents savings that would, in view of defendants' nonprofit status and the Community Commitment, invariably be passed on to consumers.

946 F. Supp. 1285, 1301 (W.D. Mich. 1996), *aff'd per curiam*, 121 F.3d 708 (6th Cir. 1997).

However, the Court's reasoning also rested on unlikely anticompetitive effects because the Community Board, the judge concluded, would not harm the community. *Id.* at 1297.

not aware of any case, and Defendants have cited none, where the merging parties have successfully rebutted the government's prima facie case on the strength of the efficiencies."[210] In the Appendix, we have identified empirical economic studies measuring either cost savings, productivity gains, or profitability from mergers, spanning industries including health insurance, banking, utility, manufacturing, beer, cotton spinning, and concrete industries.[211] For reasons we detail in the appendix, there does not seem to be any evidence that mergers result in cost savings that are passed on to consumers in lower prices.

Third, even if there were cost savings that are passed on following a merger, it is unlikely that such savings are merger-specific, as required by the Merger Guidelines.[212] As the 1968 Merger Guidelines acknowledged, economies of scale and scope "can normally be realized through internal expansion."[213] Indeed, firms that have existed in a market for some time are unlikely to continue to have unexploited economies of scale or scope. Professor of law and economics, Louis Kaplow agreed in a recent paper:

> Yet another alternative to merger is internal growth by the prospective acquirer. Instead of purchasing the target's assets, it could replicate them, expand on its own, and, if it is indeed more efficient, ultimately displace the target. Many firms such as Walmart have primarily grown (in this instance, at the retail level) through internal expansion rather than acquisition.[214]

Often, other types of cost savings also cannot be shown to be merger-specific. The 1997 Merger Guidelines explicitly stated that so-called efficiencies "relating to procurement, management, or capital cost are less likely to be merger-specific."[215] Transactions cost savings may be achievable through contracting or licensing, but, to show that these savings are merger-specific, the merging party should be required to

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Though reversed on appeal, the district court in *FTC v. H.J. Heinz, Co.* found efficiencies outweighed anticompetitive effects. 116 F. Supp. 2d 190, 198–99 (D.D.C. 2000), *rev'd*, 246 F.3d 708 (D.C. Cir. 2001). The D.C. Circuit held that "the district court failed to make the kind of factual determinations necessary to render the appellees' efficiency defense sufficiently concrete to offset the FTC's prima facie showing." *H.J. Heinz Co.*, 246 F.3d at 722.

Of particular note is then-Judge Kavanaugh's dissent in *United States v. Anthem, Inc.*: "The case law of the Supreme Court and this Court, as well as the Government's own Merger Guidelines, establish that we must consider the efficiencies and consumer benefits of a merger together with its anti-competitive effects." 855 F.3d 345, 431 (D.C. Cir. 2017) (Kavanaugh, J., dissenting) (first citing United States v. Gen. Dynamics Corp., 415 U.S. 486, 498–500 (1974); then citing *H.J. Heinz Co.*, 246 F.3d at 720; then citing United States v. Baker Hughes, Inc., 908 F.2d 981, 990–91 (D.C. Cir. 1990); and then citing 2010 HORIZONTAL MERGER GUIDELINES, *supra* note 10, § 10, at 29–31 (2010)).

It may very well be that the efficiency section of the Merger Guidelines will increasingly help defendants. In a recent example, *United States v. JetBlue Airways Corp.*, the court was satisfied that that merging parties' efficiency arguments rebutted the government's prima facie case. No. CV 23-10511-WGY, 2024 WL 162876, at *26–27 (D. Mass. Jan. 16, 2024). The court stated the defendants "met their relatively low burden," but nonetheless blocked the merger due to additional anticompetitive effects. *Id.* at *36–37.

210. FTC v. Peabody Energy, 492 F. Supp. 3d 865, 913 (E.D. Mo. 2020).

211. We review these studies in the Appendix.

212. 2023 MERGER GUIDELINES, supra note 32, at § 3.3.

213. 1968 MERGER GUIDELINES, *supra* note 9, § I; Fisher & Lande, *supra* note 14, at 1585 n.21, 1664 ("[I]t would be extremely difficult for merging firms to prove that they could not attain the anticipated [so-called] efficiencies or quality improvements through internal expansion . . . .").

214. Louis Kaplow, *Efficiencies in Merger Analysis*, 83 ANTITRUST L.J. 557, 583 & n.63 (2021).

215. 1997 HORIZONTAL MERGER GUIDELINES, *supra* note 20, § 4.

show that there are institutional barriers to contracting, such as inability to control opportunism or hold up concerns.[216] Since the transaction is ex ante, this might be difficult to show with any degree of certainty.

Fourth, verifying predicted post-merger cost savings, as required by the Merger Guidelines,[217] is likely even more challenging than demonstrating the lack of alternatives to their achievement absent the merger. Claims of dynamic cost savings are notoriously subject to difficulties of proof. The 1997 Horizontal Merger Guidelines state that claimed efficiencies "relating to research and development, are potentially substantial but are generally less susceptible to verification."[218] Joseph Brodley made a similar claim in his 1987 paper: "[I]nnovation efficiency appears resistant to measurement because it is difficult to assess the efficiency consequences of alternative innovation decisions. Thus, if a particular transaction is foreclosed by antitrust law, the firm presumably would not abandon all research effort, but instead would take a different innovation path."[219] Likewise, transactional cost savings are difficult to verify. According to John Kwoka, vertical so-called "efficiencies" "pose substantial problems of identification and measurement."[220]

The Merger Guidelines rebuttal section should be abandoned based on the combination of the four factors discussed above: lower prices do not reduce concentration, unlike entry; horizontal merger efficiencies are mythical creatures; even if such creatures existed, they do not necessarily arise from the merger; and verification of the mythical proves improbable, if not impossible.

CONCLUSION

Since the 1968 Merger Guidelines were issued, they have incorporated, to one extent or another, what we refer to as the "Merger Efficiency Fallacy." The Fallacy begins by adopting the businessman's definition of efficiency as cost savings. This definition can be justified only by acceptance of the consumer welfare standard introduced by Robert Bork in the 1970s. But that theory of welfare has proven to be ethically inappropriate and potentially inconsistent and has been rejected by modern welfare economists. The few attempts to justify the cost savings definition of efficiency—by linking it to Pareto efficiency—have proven to rely on untenable assumptions, and economists who study other areas of the law have not claimed that efficiencies are cost savings as have antitrust economists. But we are not doomed to repeat or continue past mistakes. Efficiency was never the predominant goal of the

216. "Holdup occurs when one contracting party threatens another with economic harm unless concessions are granted by the threatened party." D. Gordon Smith & Brayden G. King, *Contracts as Organizations*, 51 ARIZ. L. REV. 1, 17–18 (2009).

217. 2023 MERGER GUIDELINES, *supra* note 32, § 3.3.

218. 1997 HORIZONTAL MERGER GUIDELINES, *supra* note 20, § 4, at 29.

219. Joseph Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020, 1029 (1987); *see also* Kwoka, *supra* note 27, at 238 ("[Dynamic efficiencies] require[] an analysis not just of economies of scale in R&D but also the specific research capabilities of the merging firms, the nature of their intellectual property, the impediments that might be surmounted by merger, the prospects for integrating operations, and the competitors who may be working on the same matters.").

220. Kwoka, *supra* note 27, at 242.

antitrust laws. Rather, the laws' framers were concerned with preventing adverse income transfers, protecting political democracy, and protecting small businesses and opportunities for entrepreneurship from the threats arising from the concentration of too much economic power in the hands of a few. Pursuit of these original congressional goals of antitrust fit nicely into the modern welfare framework, and we have offered herein an approach for incorporating these congressional values into the Merger Guidelines. Finally, we have provided several reasons why the New Merger Guidelines rebuttal efficiency approach is both inconsistent and of little practical value and should be abandoned.[221]

APPENDIX: EFFECT OF HORIZONTAL MERGERS ON COST SAVINGS

This Appendix reviews empirical literature on the effect of horizontal mergers on cost savings and other economic outcomes including price, quality, quantity, and investment in the research and development (R&D) of relevant products to further test whether there is any substantial basis to preserve what we have termed the "Merger Efficiency Fallacy."

We include studies touted by Maureen Ohlhausen and Taylor Owings' article,[222] commissioned by the U.S. Chamber of Commerce. Ohlhausen and Owings contended that "there is evidence of mergers leading to efficiencies in a wide range of industries," using a plethora of studies as support. Strictly speaking, their evidence has nothing to do with "efficiency" as understood by the general economics profession, it only has to do with cost reductions. Since firms' costs are input suppliers' incomes or revenues, they are not necessarily welfare-increasing from a social point of view.

Setting aside this fundamental point, we critically evaluate the cost reductions claimed by most of the papers cited by Ohlhausen and Owings in this appendix.[223] We

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221. Further, we do not find the claim that large firms with market power are needed to compete with large foreign firms. There is no evidence that market power improves ability to compete internationally. *See generally* MICHAEL E. PORTER, HIROTAKA TAKEUCHI & MARIKO SAKAKIBARA, CAN JAPAN COMPETE? (1998).

222. *See generally* MAUREEN K. OHLHAUSEN & TAYLOR M. OWINGS, U.S. CHAMBER OF COM., EVIDENCE OF EFFICIENCIES IN CONSUMMATED MERGERS (2023), https://www.uschamber.com/assets/documents/20230601-Merger-Efficiencies-White-Paper.pdf [https://perma.cc/3WU9-6TRY]. It is regrettable that this paper cited a critique of Kwoka's book on mergers, *Mergers, Merger Control, and Remedies*, but not Kwoka's very effective reply to that critique. *See id.* at 8 n.28 (citing Michael Vita & F. David Osinski, *John Kwoka's Mergers, Merger Control, and Remedies: A Critical Review*, 82 ANTITRUST L.J. 361, 377–81 (2018) (critiquing Kwoka's book)); *see also* John Kwoka, *Mergers, Merger Control, and Remedies: A Response to the Vita-Osinski Critique*, 82 ANTITRUST L. J. 741 (2019) (responding to the critique). *See generally* JOHN KWOKA, MERGERS, MERGER CONTROL, AND REMEDIES: A RETROSPECTIVE ANALYSIS OF U.S. POLICY (2015).

223. In the interest of brevity, if a paper cited by Ohlhausen and Owings is the sole paper covering a given industry, we cover it in this note. *See* OHLHAUSEN & OWINGS, *supra* note 222, at 14, 15, 21, 22, 26. Siebert, studying the DRAM market, did not even observe costs. Ralph B. Siebert, *Estimating Differential Dynamic Merger Effects on Market Structure and Entry in Related Markets*, 55 REV. INDUS. ORG. 431, 440 (2019) ("[P]re- and post-merger marginal costs are unobserved"). Zhang, studying bottled water, set up a simulation model in which the firm chooses product variety and quantity of advertising based on the cost of product variety and of advertising; observed that post-merger, product variety and quantity of advertising increase; and then inferred that the merger must have decreased the cost of product variety and the cost of advertising—because what else in his model could have been responsible? In the real world, however, something else—e.g., loosening the "financial impediments" noted by Siebert, *supra* at 455, as affecting small firms—could well have been responsible instead. Jun Zhang, *What Makes a Good Merger? An Analysis of*

include additional published peer-reviewed empirical papers treating the effect of horizontal mergers on cost. We also include some papers studying other economic outcomes such as price, quality, quantity, or investment in R&D. However, in choosing these additional studies, we have excluded ones based on market structure, merger simulation, and stock-market event studies, for the reasons explained by Kwoka.[224]

A. Mergers and Cost Savings

Our review of the papers examining cost savings attributable to mergers suggests that the evidence is slim to none. The cost savings either do not materialize or are not merger-specific.

Stavros Peristani studied the post-merger efficiencies of bank mergers in 1980–1990 and, rather than finding any evidence of persisting cost savings, Peristani found a small but significant decrease in "X-efficiency" (efficiency of producing a given output mix), two to four years after the merger.[225] He concluded that there was "no evidence to support the theory that in-market mergers lead to significant improvements in efficiency."[226] Ohlhausen and Owings cited several other banking studies. However, like Peristani,[227] they all modeled banks using the "intermediation theory of banking," which posits that banks lend out money which depositors deposit in the bank.[228] This theory of banking is completely obsolete, as the Bank of England has

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Merger Efficiencies in the U.S. Bottled Water Industry, SSRN (Nov. 8, 2018), https://ssrn.com/abstract=3284249 [https://perma.cc/FEV7-ECS9]. Sullivan, studying accounting firms, found that merging gave them an advantage in obtaining the business of large firms, but gave them a *disadvantage* in gaining the business of small firms. Mary W. Sullivan, *The Effect of the Big Eight Accounting Firm Mergers on the Market for Audit Services*, 45 J.L. & ECON. 375, 396 (2002) ("Figures 2–5 show that the merged firms were more successful in winning large clients after the mergers than before the mergers. . . . At the same time, the share of small clients won by the merged firms decreased after the merger . . . ."). Hensel studied "costs" in the defense industry, but these "costs" were not actually input costs to the firm, they were the firms' output prices, i.e., they were the "costs" of the *purchaser*, the U.S. Department of Defense, whose perspective would be quite natural for Hensel to take because it was her employer at the time. Nayantara Hensel, *Can Industry Consolidation Lead to Greater Efficiencies? Evidence from the U.S. Defense Industry*, 45 BUS. ECON. 187, 188 (2010) ("[T]his analysis is the first to examine in detail whether the costs faced by DoD for specific weapons systems . . . increased or decreased following a merger . . . ."). Kendix and Walls also studied price not costs. Michael Kendix & W.D. Walls, *Oil Industry Consolidation and Refined Product Prices: Evidence from US Wholesale Gasoline Terminals*, 38 ENERGY POL'Y 3498, 3506 (2010) ("Our objective in this paper was to quantify the impact of petroleum industry consolidation on refined product prices."). Ueda used simulation, but as we observed with Zhang's paper, this technique is very sensitive to an author's modeling assumptions, and is therefore one which has not proven to be very reliable, as explained further by Kwoka. Masahiro Ueda, *The Success or Failure of Mergers in Japan's Paper Industry: Evaluation of Merger Effects using DEA and Simulation Data*, 14 INT'L J. ECON. POL'Y STUD. 179, 180 (2020) ("This article creates simulations of data on hypothetical mergers . . . ."); *see also* KWOKA, *supra* note 222.

224. KWOKA, *supra* note 222, § 3.2, at 40–47.

225. Stavros Peristiani, *Do Mergers Improve the X-Efficiency and Scale Efficiency of U.S. Banks? Evidence from the 1980s*, 29 J. MONEY CREDIT & BANKING 326, 336 (1997).

226. *Id.* at 326.

227. *Id.* at 328.

228. Jalal D. Akhavein, Allen N. Berger & David B. Humphrey, *The Effects of Megamergers on Efficiency and Prices: Evidence from a Bank Profit Function*, 12 REV. INDUS. ORG. 95, 107 (1997); Adel A. Al-Sharkas, M. Kabir Hassan & Shari Lawrence, *The Impact of Mergers and Acquisitions on the Efficiency of the U.S. Banking Industry: Further Evidence*, 35 J. BUS. FIN. & ACCT. 50, 55 (2007). Dimitris K.

explained: banks in the modern world actually create out of thin air the money they lend out.[229] This makes banking completely different from industries that produce physical outputs, and makes it unclear what the costs of making a loan really are. Studies that do not reflect this do not engender confidence.

J. David Cummins, Sharon Tennyson, and Mary Weiss examined the cost and revenue efficiency of the U.S. life insurance industry in 1988–1995 and found that acquired firms had more efficiency gains than firms that had not been involved in mergers or acquisitions.[230] However, unlike in most other industries, acquisitions in the life insurance industry are usually not "mergers" as commonly understood; instead, "many transactions involve groups buying and selling companies that remain in existence after the transaction," and a company may be "purchased by one group and then later sold to another."[231] So these conclusions are not applicable to mergers of the more typical type, in which the merged entities do not remain distinct.

John Becker-Blease, Lawrence Goldberg, and Fred Kaen studied mergers in the electric power industry after deregulation and found little evidence that the mergers and acquisitions created long-term value. Indeed, the stock price and business performance of the acquirers underperformed those of nonmerging firms.[232] The authors inferred from this data that, even if efficiencies and synergies are created as a result of deregulation, utilities do not have to grow through merger to capture them.[233] This points out an issue often ignored in merger studies: cost savings due to a merger cannot be used to support the merger unless the cost savings could not have come about in any other way but a merger. The cost savings must be merger-specific, must be "cognizable." The same concern appears in an electric power study cited by Ohlhausen and Owings, finding that that mergers result in cost savings because of management

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Chronopoulos, Claudia Girardone & John C. Nankervis, *Post-Merger Bank Efficiency and Stock Market Reaction: The Case of the US Versus Europe*, *in* NEW ISSUES IN FINANCIAL INSTITUTIONS MANAGEMENT 122, 128 (Franco Fiordelisi, Philip Molyneux & Daniele Previati eds., 2010); Dimitris K. Chronopoulos, Claudia Girardone, & John C. Nankervis, *How Do Stock Markets in the US and Europe Price Efficiency Gains from Bank M&As?*, 43 J. FIN. SERVS. RSCH. 243, 249 (2013); Jamal Ali Al-Khasawneh, *Pairwise X-Efficiency Combinations of Merging Banks: Analysis of the Fifth Merger Wave*, 41 REV. QUANTITATIVE FIN. & ACCT. 1, 10 (2013). It is not clear what theory of banking the Galariotis paper is using because it is not clear what that paper is taking as the inputs and outputs of the banking industry. Emilios Galariotis, Kriaki Kosmidou, Dimitrios Kousenidis, Eirini Lazaridou & Trifon Papapanagiotou, *Measuring the Effects of M&A on Eurozone Bank Efficiency: An Innovative Approach on Concentration and Credibility Impacts*, 306 ANNALS OPERATIONS RSCH. 343 (2021).

229. Michael McLeay, Amar Radia & Ryland Thomas, *Money Creation in the Modern Economy*, 54 BANK ENG. Q. BULL. 14, 15–16 (2014), https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2014/quarterly-bulletin-2014-q1.pdf [https://perma.cc/6VW7-6FC5].

230. J. David Cummins, Sharon Tennyson & Mary A. Weiss, *Consolidation and Efficiency in the US Life Insurance Industry*, 23 J. BANKING & FIN. 325, 355 (1999).

231. *Id.* at 330, 333.

232. John R. Becker-Blease, Lawrence G. Goldberg & Fred R. Kaen, *Mergers and Acquisitions as a Response to the Deregulation of the Electric Power Industry: Value Creation or Value Destruction?*, 33 J. REGUL. ECON. 21, 22 (2008).

233. *Id.* at 52.

changes (there were no new large capital investments).[234] This means that the cost savings could have been achieved just by replacing a few managers, instead of by merging. These cost reductions were not merger-specific.

Exactly the same objection applies to a paper cited by Ohlhausen and Owings studying mergers in the concrete industry. Robert Kulick analyzed horizontal mergers in the ready-mix concrete industry from 1977 to 1992.[235] He found evidence of significant price increases associated with horizontal mergers. He did find substantial productivity gains using a revenue-based measure of total factor productivity, which can be seen as a potential benefit of these mergers, but he states, "Thus, the fundamental mechanism driving productivity increases appears to be one where more productive managers take less productive assets and raise them to a level of productivity commensurate with their own."[236] This is not a cognizable cost saving: some managers could have been hired away from one firm by another, instead of having the two firms merge. Moreover, it shows that the technology was mis-specified—management of different qualities should have been included as inputs, and firms were irrationally using too much of the low-quality managerial input and too little of the high-quality managerial input, challenging the methodology of papers like this which assume cost-minimizing firms.[237]

Going back to electricity generation, Kwoka and Michael Pollitt found results similar to those of Becker-Blease, Goldberg, and Kaen.[238] They studied the performance impact of mergers that occurred in the U.S. electricity industry from 1994 to 2003 and examined the impact on operating and total costs in electricity distribution.[239] They found that mergers do not lead to lower costs for acquiring companies.[240] Instead, buyers tended to be less cost-efficient performers before the merger, and sellers, who were more cost efficient, saw their efficiency decline after the merger.[241] As the authors put it, this paper had "some of the strongest evidence against the theory of efficient mergers and the market for corporate control."[242]

Serguey Braguinsky, Atsushi Ohyama, Tetsuji Okazaki, and Chad Syverson studied acquisitions in the Japanese cotton spinning industry in the late nineteenth and the early twentieth century (1896–1920).[243] They found that the acquired firms'

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234. Mert Demirer & Ömer Karaduman, *Do Mergers and Acquisitions Improve Efficiency: Evidence From Power Plants* § 7.3, at 38–40 (FTC Microeconomics Conf., Nov. 4, 2022), https://www.ftc.gov/system/files/ftc_gov/pdf/demirerkaraduman.pdf [https://perma.cc/9DPV-V38S].

235. Robert Kulick, *Ready-to-Mix: Horizontal Mergers, Prices, and Productivity* 35 (U.S. Census Bureau, Working Paper No. CES 17-38, 2017), https://www2.census.gov/ces/wp/2017/CES-WP-17-38.pdf [https://perma.cc/HGH9-RLNJ].

236. *Id.* at 28.

237. *Id.* at 8 (assuming cost-minimizing firms).

238. *See* John Kwoka & Michael Pollitt, *Do Mergers Improve Efficiency? Evidence from Restructuring the US Electric Power Sector*, 28 INT'L J. INDUS. ORG. 645, 654 (2010).

239. *Id.*

240. *Id.*

241. *Id.*

242. *Id.*

243. Serguey Braguinsky, Atsushi Ohyama, Tetsuji Okazaki & Chad Syverson, *Acquisitions, Productivity, and Profitability: Evidence from the Japanese Cotton Spinning Industry*, 105 AM. ECON. REV. 2086, 2086, 2092 (2015).

production facilities saw drops in inventory and gains in capacity utilization post-acquisition, leading to increased productivity and profitability.[244] However, they did not find any reduction in price as a result of the increased productivity.[245] Also, this is a managerial improvement story, so, like our above discussion of power plants and concrete, these cost savings were probably not merger-specific.

Orley Ashenfelter, Daniel Hosken, and Matthew Weinberg studied the Miller and Coors merger and the U.S. beer industry overall, and they concluded that "there is little evidence that efficiencies can offset incentives to raise prices following mergers."[246] They found that even when there are moderate cost savings efficiencies, the savings are not passed to consumers, as the increase in concentration leads to an increase in market power and, therefore, an ability to sustain price increases. In a later study, Miller and Weinberg examined the Miller-Coors joint venture and reported a significant increase in the prices of beer after the merger. They estimated a moderate reduction in marginal cost of only 14%.[247] Furthermore, the cost savings highlighted by Ashenfelter et al. were transportation costs, but these savings could have been achieved short of a merger, by one firm licensing its beer to be produced in some of the other firm's plants. In other words, the cost savings were not merger specific.

Bruce Blonigen and Justin Pierce studied the U.S. manufacturing industry by comparing the productivity gains and the increase in market power resulting from mergers and acquisitions.[248] They found that market power usually increases following a merger or acquisition, while plant-level productivity usually remains unchanged, at best. Specifically, they found little evidence of beneficial plant- or firm-level productivity effects from merger and acquisition activity, on average, and found little evidence for other efficiency gains often cited as possible from merger and acquisition activity, including reallocation of activity across plants or scale efficiencies in non-productive units of the firm.

Another horizontal-merger paper in Ohlhausen and Owings's list is a study of a Hawaiian cement merger. It found that the price of cement fell after a merger; however, pre-merger Hawaiian capacity utilization was 37.5%, well below the U.S. industry average of 64.6%, so falling price might have been caused by further deterioration of demand, rather than falling costs.[249]

Yet another group of studies cited by Ohlhausen and Owings concern hospital mergers. These are fundamentally flawed because they do not hold quality of care

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244. *Id.* at 2117.

245. *Id.* at 2100.

246. Orley C. Ashenfelter, Daniel S. Hosken & Matthew C. Weinberg, *Efficiencies Brewed: Pricing and Consolidation in the US Beer Industry*, 46 RAND J. ECON. 328, 328 (2015).

247. Nathan H. Miller & Matthew C. Weinberg, *Understanding the Price Effects of the MillerCoors Joint Venture*, 85 ECONOMETRICA 1763, 1782 (2017).

248. Bruce A. Blonigen & Justin R. Pierce, *Evidence for the Effects of Mergers on Market Power and Efficiency* 2 (Bd. Governors Fed. Rsrv. Sys., Fin. & Econ. Discussion Series Working Paper No. 82, 2016), https://www.federalreserve.gov/econresdata/feds/2016/files/2016082pap.pdf [https://perma.cc/F4M2-7E9C].

249. LAURENCE SCHUMANN, ROBERT P. ROGERS & JAMES D. REITZES, FTC, CASE STUDIES OF THE PRICE EFFECTS OF HORIZONTAL MERGERS pt. IV, at 35–50, 36 & n.32 (1992), https://www.ftc.gov/sites/default/files/documents/reports/case-studies-price-effects-horizontal-mergers/232213.pdf [https://perma.cc/HDW6-QPQW]. Note that their demand equation had no time trend. *Id.* at 6, fig.II.1.

constant. In most of these studies, the output (or one of the outputs) is time spent in a hospital, yet Groff et al. point out that "inpatient days can be viewed as either an input or an output depending on the perspective of the researcher."[250] The output of a hospital should be quality medical care; being unable to hold quality constant means these papers' "efficiency" calculations are meaningless.

Most of these papers do not even acknowledge this problem,[251] but two of them do.[252] Moreover, one study admits it cannot measure the deleterious effect hospital mergers might have on care for the uninsured, while it noted, qualitatively, the bad effect of a merger on a hospital "where the doctors paid attention to their patients."[253] Another admits it cannot measure the deleterious effect of hospital mergers on local healthcare employment and on "inconvenience costs resulting from service consolidations."[254] (All of these shortcomings are common to all of these studies—the others did not even mention them.)

Another group of studies cited by Ohlhausen and Owings concern airlines. One study showed that airfares decreased and number of flights increased following formation of an airline alliance.[255] However, that study had no data on costs or quality (flight delays and cancellations). Additionally, an alliance is not a merger, and could actually serve as a substitute for a merger. Another paper studied an actual merger and found price decreases for non-overlapping routes and price increases for overlapping routes.[256] It did not have data on costs or quality either. Another paper on an actual merger, yet again with no direct data on costs, found mixed effects on prices (price

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250. James E. Groff, Donald Lien & Jiwei Su, *Measuring Efficiency Gains from Hospital Mergers*, 11 RSCH. HEALTHCARE FIN. MGMT. 77, 82–83 (2007).

251. *See, e.g.*, Jeffrey A. Alexander, Michael T. Halpern & Shoou-Yih D. Lee, *The Short-Term Effects of Merger on Hospital Operations*, 30 HEALTH SERVS. RSCH. 827 (1996); Jason R. Barro & David M. Cutler, *Consolidation in the Medical Care Marketplace: A Case Study from Massachusetts*, *in* MERGERS AND PRODUCTIVITY 9 (Steven N. Kaplan ed., 2000); Heather Radach Spang, Gloria J. Bazzoli & Richard J. Arnould, *Hospital Merger and Savings for Consumers: Exploring New Evidence*, 20 HEALTH AFFS. 150 (2001); David Dranove & Richard Lindrooth, *Hospital Consolidation and Costs: Another Look at the Evidence*, 22 J. HEALTH ECON. 983, 987 (2003) (unclear output measure); G.D. Ferrier & V.G. Valdmanis, *Do Mergers Improve Hospital Productivity?*, 55 J. OPERATIONAL RSCH. SOC'Y 1071 (2004). For confirmation that hospital quality after mergers is a valid concern, though not easy to definitively study, see Vivian Ho & Barton H. Hamilton, *Hospital Mergers and Acquisitions: Does Market Consolidation Harm Patients?*, 19 J. HEALTH ECON. 767 (2000). Mixed quality of care outcomes are reported by Nancy D. Beaulieu, Leemore S. Dafny, Bruce E. Landon, Jesse B. Dalton, Ifedayo Kuye & J. Michael McWilliams, *Changes in Quality of Care After Hospital Mergers and Acquisitions*, 382 NEW ENG. J. MED. 51 (2020), https://www.nejm.org/doi/full/10.1056/NEJMsa1901383 [https://perma.cc/JM6Q-8YK9].

252. Robert A. Connor, Roger D. Feldman & Bryan E. Dowd, *The Effects of Market Concentration and Horizontal Mergers on Hospital Costs and Prices*, 5 INT'L J. ECON. BUS. 159, 160 (1998); Heather Radach Spang, Richard J. Arnould & Gloria J. Bazzoli, *The Effect of Non-Rural Hospital Mergers and Acquisitions: An Examination of Cost and Price Outcomes*, 49 Q. REV. ECON. & FIN. 323, 341 (2009).

253. Jason R. Barro & David M. Cutler, *Consolidation in the Medical Care Marketplace: A Case Study from Massachusetts*, *in* MERGERS AND PRODUCTIVITY 9, 33–41 (Steven N. Kaplan ed., 2000).

254. Groff et al., *supra* note 250, at 88.

255. Gustavo E. Bamberger, Dennis W. Carlton & Lynette R. Neumann, *An Empirical Investigation of the Competitive Effects of Domestic Airline Alliances*, 47 J.L. & ECON. 195, 195 (2004).

256. Kai Hüschelrath & Kathrin Müller, *Airline Networks, Mergers, and Consumer Welfare*, 48 J. TRANSP. ECON. & POL'Y 385, 386 (2014).

decreases in larger markets and price increases in smaller market) and mixed effects on quality (cancellations fell but delays rose).[257]

Ohlhausen and Owings also list Yonghong An and Wei Zhao's study of the 1997 merger of airplane manufacturers Boeing and McDonnell-Douglas.[258] This was a simulation study, thus subject to the criticisms referred to in *supra* note 223, so we leave detailed critique to a footnote.[259] However, we should raise the topic of quality and safety. Since the 2018 crash of a Boeing 737 Max 8, Boeing has compiled a troubling safety record, and concerned observers in the U.S. probably wish there were a U.S. alternative to Boeing for safety's sake—but there is none. If Boeing whistleblower Ed Pierson is to be believed, Boeing did achieve financial cost reductions under visionary new management techniques in the 2010s,[260] but quality was not held constant—quality fell by 346 lives[261] and counting. As with hospitals, airplane merger studies not holding quality constant are deeply problematic, highlighting easily-measured cost reductions while ignoring quality deteriorations foisted onto unsuspecting consumers.

257. Somnath Das, *Effect of Merger on Market Price and Product Quality: American and US Airways*, 55 REV. INDUS. ORG. 339, 342 (2019).

258. Yonghong An & Wei Zhao, *Dynamic Efficiencies of the 1997 Boeing-McDonnell Douglas Merger*, 50 RAND J. ECON. 666 (2019).

259. An and Zhao find that the price of medium-sized aircraft fell after this merger. Their paper is based on a "but for" model simulation, which itself was based on assuming that the cost-reducing experiences of "learning-by-doing" and "spillovers" of constructing more than one airplane by a completely different firm (Lockheed) in a completely different time period (1968–1984) could be applied to post-1997 Boeing. *See id.* at 669–71 (basing cost information on production data for the Lockheed L-1011 and noting that Lockheed exited the market in 1984). In addition, they made the dubious assumption that "within-firm spillover[s]" could be captured by spillovers between two different firms, Lockheed and McDonnell-Douglas, "because both the L-1011 and the DC-10 plants were in the Los Angeles area, so possible workforce shifts and experience sharing between the two products may be similar to those within-firm products." *Id.* at 680 n.4. Based on that set of assumptions, An and Zhao ascribe the post-merger fall in price to more effectively shared work experiences; accelerated learning-by-doing; or experience transfer to Boeing. *Id.* at 674. Such conclusions, while certainly suggestive of a possibility, ultimately have to be considered largely speculative, because they depend on the simulation's specific functional forms used (not just for McDonnell-Douglas and Boeing but also for Airbus and airplane purchasers), the particular discount rate assumed, and possibly the particular Markov-Perfect Nash Equilibrium which the algorithm happened to find (since uniqueness of the equilibrium is not guaranteed). *Id.* at 683. In this particular case, the merger simulation results are especially dubious because one of us (Glick) worked on this merger, and heard high-ranking employees of both Boeing and McDonnell-Douglas uniformly report that McDonnell-Douglas actually had no valuable technology nor experience in the production of civilian aircraft to give to Boeing, calling into question An and Zhao's learning-by-doing and experience spillover assumptions.

260. Jonathan Chang & Meghna Chakrabarti, *A Boeing Whistleblower Speaks Out*, WBUR (Feb. 15, 2024), https://www.wbur.org/onpoint/2024/02/15/boeing-whistleblower-speaks-alaska-airlines [https://perma.cc/9MYB-27Y3] ("It was called QA Transformation Plan. Then it became what's called Verification Optimization. They removed thousands of quality control inspections . . . ." (interviewing Ed Pierson, former aviation manager, Boeing)).

261. David Schaper, *Boeing Pleads Not Guilty to Fraud in Criminal Case over Deadly 737 Max Crashes*, NPR (Jan. 26, 2023), https://www.npr.org/2023/01/26/1151565489/boeing-criminal-fraud-charge-737-max-crashes [https://perma.cc/8L2Q-QHK8].

Ohlhausen and Owings also mention the railroad industry, an industry which has seen large consolidation (thirty-six Class I railroads in 1978 to seven in 2010)[262] and (again) an industry which has seen serious safety problems.[263] As in airplanes and hospitals, economists studying railroads have not held safety constant, or even mentioned safety in their "efficiency" studies. One study, after claiming merger benefits, reports that:

> [Union Pacific (UP)] itself is now on record asserting that many claimed benefits of recent end-to-end mergers (e.g., [Burlington Northern/Santa Fe, UP/Missouri Pacific) might well have been achieved through means short of merger. UP gives as an example "long-term alliances to coordinate interline operations," made possible by rapid advances in information technology "to achieve benefits traditionally attributed to end-to-end mergers."[264]

In other words, any merger benefits were not merger-specific: interline operations and "trackage rights" (to run a train on another company's tracks) could have generated the same benefits. Another paper reports that, as of 2010, economic surplus of shippers was below its 1978 level, and total economic surplus fell after 1981, not surpassing the 1981 level until 2005 (so that a perfect-foresight analysis in 1980 would show the net present value of merger benefits being negative, certainly up to 2005, and perhaps even with an infinite time horizon).[265]

Based on these studies, we can conclude that the promise of significant cost savings or productivity gains post-merger simply do not materialize in most cases. Even in the studies that found cost savings or productivity gains post-merger, these gains were often not merger-specific.

Next, we look at the effect of mergers on price and quantity in the product market.

B. Merger Impact on Prices

Among the literature that discusses the price effects of horizontal mergers, Kwoka has performed a comprehensive meta-analysis comparing different findings.[266] Using studies that analyze one or more specific mergers and consider each one separately, he found that the post-merger price at the product-level increased by 7.22%, on average.[267] More than 80% of product prices showed increases, and those increases averaged 10.08%.[268] The largest post-merger price increases occurred in the hospital, journals,

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262. Marc Ivaldi & Gerard McCullough, *Welfare Tradeoffs in U.S. Rail Mergers* 3 (Toulouse Sch. of Econ., Working Paper No. 10-96, 2010).

263. *Factsheet on Rail Safety*, U.S. DEP'T OF TRANSP. (Apr. 2, 2024), https://www.transportation.gov/briefing-room/factsheet-rail-safety [https://perma.cc/JQM8-CCL8] ("In the early 2010s, we saw a number of high-profile freight rail incidents across the U.S. and Canada, including one that left nearly 50 people dead. . . . [A]s last year's Norfolk Southern derailment in East Palestine demonstrated, we can and must do more.").

264. Denis A. Breen, *The Union Pacific/Southern Pacific Rail Merger: A Retrospective on Merger Benefits*, 3 REV. NETWORK ECON. 283, 311 (2004) (footnote omitted) (quoting Union Pac. Corp., Comment on Proposed Rule for Major Rail Consolidation Procedures, 65 Fed. Reg. 58,974 (proposed Oct. 3, 2000) (codified as 49 C.F.R. § 1180 (2001)).

265. Ivaldi & McCullough, *supra* note 262, at 24–25.

266. *See generally* KWOKA, *supra* note 222.

267. *Id.* at 110, 155.

268. *Id.* at 110–11.

and airline industries, where the product-level price increased by 15%, on average, and as high as 30%, in some cases.[269] A smaller subset of these studies found that both the quantity and quality of output was reduced post-merger, though it should be noted that the total number of observations across these studies is small.[270]

Using a meta-analysis of retrospective studies of groups of mergers, Kwoka reported a product-level price increase of 5.42%.[271] Estimates of efficiency essentially average a zero change.[272] Efficiency is either a measure of overall efficiency, technical efficiency, or scale efficiency. Estimates of quality show a decrease of 4%, and estimates of R&D show a decrease of 9.73%.[273]

Kwoka's findings are based on exhaustive research of studies on horizontal mergers available up through 2011.[274] We supplement his findings by including more recent studies of price effects of horizontal mergers. Most of these studies found net harm in horizontal mergers, as prices usually increase for consumers.

Nine recent papers study the price effects of horizontal mergers at the industry level, with eight using the U.S. product markets and one using Japanese market data. Of these nine papers, seven found net harm in the form of increased prices. Price increases can result from the change in market concentration and market power.[275]

Thus, the literature suggests that most studied mergers result in competitive harm, usually in the form of higher prices or reductions in quantity, quality, and R&D.

Our conclusions are aligned with the assertions of Nancy Rose and Jonathan Sallet: "[C]onsummated horizontal mergers, particularly in concentrated markets, frequently are associated with consumer losses, and infrequently associated with consumer benefits. This is consistent with market power effects dominating any potential efficiency gains, or no efficiencies at all."[276]

269. *Id.* at 98–99, 155.

270. *Id.* at 99–100.

271. *Id.* at 147–48.

272. *Id.* at 148.

273. *Id.*

274. *See id.* App. II, at 219–39.

275. *See, e.g.*, Ashenfelter et al., *supra* note 246, at 328; Volker Nocke & Michael D. Whinston, *Concentration Thresholds for Horizontal Mergers*, 112 AM. ECON. REV. 1915 (2022); Kulick, *supra* note 235; Leemore Dafny, Kate Ho & Robin S. Lee, *The Price Effects of Cross-Market Mergers: Theory and Evidence from the Hospital Industry*, 50 RAND J. ECON. 286 (2019); Blonigen & Pierce, *supra* note 248; Ralph Siebert, *The Impact of Horizontal Mergers on Market Structure: Evidence from the Semiconductor Industry* (Ctr. Econ. Stud. & ifo Inst., Working Paper No. 5911, 2016); Miller & Weinberg, *supra* note 247, at 1764.

276. Rose & Sallet, *supra* note 200, at 1963.

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NOTES

"DEEPLY EMBEDDED": *ARKANSAS TIMES LP V. WALDRIP* AND THE RIGHT TO BOYCOTT*

I. INTRODUCTION

On February 21, 2023, the Supreme Court denied certiorari in *Arkansas Times LP v. Waldrip* (*Waldrip III*).[1] Opponents of the Boycott, Divestment, Sanctions (BDS) campaign rejoiced, claiming victory.[2] And they could, at least for the time being. The Court, by not considering the question presented—whether Arkansas could require those seeking state contracts to certify that they were not engaged in a boycott of Israel, and would not be for the life of the contract—provided opponents of BDS with a judicial blessing for their counter-campaign.[3] This effect of the holding was made clear in the response of Kenneth Marcus, founder and chairman of the Louis D. Brandeis Center for Human Rights Under Law; he stated: "Today is a great day for the cause of justice. This morning, the U.S. Supreme Court let stand an important appeals court victory for anti-BDS legislation and civil rights law by denying cert. in the Arkansas anti-BDS case, *Arkansas Times LP v. Waldrip*."[4]

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1. Ark. Times LP v. Waldrip (*Waldrip III*), 37 F.4th 1386 (8th Cir. 2022) (en banc), *cert. denied*, 143 S. Ct. 774 (2023); Eugene Volokh, *S. Ct. Denies Review of Eighth Circuit En Banc Case Upholding Arkansas "Anti-BDS" Statute*, REASON: VOLOKH CONSPIRACY (Feb. 21, 2023, 11:44 AM), https://reason.com/volokh/2023/02/21/s-ct-denies-review-of-eighth-circuit-en-banc-case-upholding-arkansas-anti-bds-statute/ [https://perma.cc/MUB7-4NF5].

2. *See, e.g.*, ADL (@ADL), TWITTER (Feb. 22, 2023, 3:43 PM), https://twitter.com/ADL/status/1628495721191145474 [https://perma.cc/EM2Z-C8UZ] ("We welcome the Supreme Court's decision not to hear Arkansas Times LP v. Waldrip, a case that upheld Arkansas' anti-BDS law. BDS seeks to delegitimize Israel and undermines a peaceful resolution to the I-P conflict. States should have the right to use legal means to fight it."); Tom Cotton (@TomCottonAR), TWITTER (Feb. 21, 2023, 10:56 AM), https://twitter.com/TomCottonAR/status/1628061125290913793 [https://perma.cc/7JTY-BEU6] ("A great win for Arkansas and America in the fight against the anti-Semitic BDS movement. Outstanding news.").

3. *See* Andrew Chung, *U.S. Supreme Court Spurns Challenge to Arkansas Law Against Contractors Boycotting Israel*, REUTERS (Feb. 21, 2023), https://www.reuters.com/legal/us-supreme-court-spurns-challenge-arkansas-law-against-contractors-boycotting-2023-02-21 [https://perma.cc/B2JA-FAAZ].

4. Press Release, Kenneth L. Marcus, Chairman, Brandeis Ctr., Brandeis Center Statement on Supreme Court Action Letting Arkansas Anti-BDS Law Stand (Feb. 21, 2023), https://brandeiscenter.com/brandeis-center-statement-on-supreme-court-action-letting-arkansas-anti-bds-law-stand/ [https://perma.cc/C4PD-YM65] ("Anti-Israel boycotts will now be seen for what they are: discriminatory conduct rather than political speech."); *see also* David Israel, *US Supreme Court Lets Stand Arkansas' Anti BDS Law*, JEWISH PRESS (Feb. 22, 2023), https://www.jewishpress.com/news/us-news/us-supreme-court-lets-stand-arkansas-anti-bds-law/2023/02/22/ [https://perma.cc/AXV4-FJ4D].

For proponents of BDS, perhaps the most prominent campaign to support international pressure on Israel regarding its treatment of Palestinians, the decision was a setback.[5] Arkansas is one of dozens of states with such a law on the books.[6] And prior to the Eighth Circuit's decision to uphold the Arkansas law in 2022, no anti-boycott law of similar content had ever survived appellate-level scrutiny.[7] At the time of the Supreme Court's denial of certiorari to the Eighth Circuit case, a similar case was pending in the Fifth Circuit.[8] There was a glimmer of hope for BDS proponents that the Fifth Circuit would find Texas's version of the law to be unconstitutional, creating a circuit split and paving the way for the Supreme Court to be more amenable to an appeal in the next term.[9] But in July 2023, the Fifth Circuit dismissed the suit for lack of standing, vacating the injunction that had been placed on enforcement of the Texas law.[10]

How did the Eighth Circuit come to a different conclusion than the district courts that preceded it? This Note argues that a close read of the decision reveals a failure to apply settled law on boycotts and the protections of the First Amendment. Rather than relying on longstanding precedent regarding the explicit protections for certain political boycotts expressed by the Supreme Court in *NAACP v. Claiborne Hardware Co.*, the Eighth Circuit reinterpreted the holding, with irresponsibly thin justification.[11] In so doing, it failed to recognize that the challenged law constituted viewpoint discrimination.

This Note begins by providing the facts and procedural history of *Waldrip III* in Section II. Parts III.A and III.B recount the history of the BDS movement and its predecessors, as well as the legislative response to boycotts of Israel at the state and federal levels in the United States. Then, Part III.C explores the major First Amendment decisions primarily relied upon by each party in *Waldrip III*—namely, *Claiborne* and *Rumsfeld v. Forum for Academic and Institutional Rights, Inc.* (*FAIR*).[12] Part III.D provides the history of federal court decisions regarding laws substantially similar to the one at issue in *Waldrip III*.

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5. Chung, *supra* note 3.

6. ARK. CODE. ANN. § 25-1-503 (West 2024); *see also Types of Legislation*, PALESTINE LEGAL, https://legislation.palestinelegal.org/types-of-legislation/ [https://perma.cc/G5MS-FU7V] (last visited Apr. 21, 2024); *see also infra* Part III.B.2.

7. *Types of Legislation*, *supra* note 6. Virginia has passed a nonbinding resolution that condemns "the international Boycott, Divestment, and Sanctions movement and its activities in Virginia," but efforts to institute anti-boycott legislation have otherwise failed. *Id.*; *see also* H.R.J. Res. 177, 2016 Leg., Reg. Sess. (Va. 2016).

8. *See* A&R Eng'g & Testing, Inc. v. Scott, 72 F.4th 685 (5th Cir. 2023); *CAIR To Deliver Oral Argument in Texas Free Speech Anti-BDS Case*, CAIR-TEX. (Nov. 4, 2022), https://www.cairdfw.org/index.php/component/content/article/281-cair-to-deliver-oral-argument-in-texas-free-speech-anti-bds-case [https://perma.cc/H7JT-X6RZ].

9. PHILIP ALLEN LACOVARA, FEDERAL APPELLATE PRACTICE § 17.1(c)(1) (2008) (explaining that circuit court splits tend to lead to certiorari).

10. *A&R Eng'g & Testing, Inc.*, 72 F.4th at 691.

11. 458 U.S. 886 (1982); *see also Waldrip III*, 37 F.4th 1386, 1391–92 (8th Cir. 2022) (en banc), *cert. denied*, 143 S. Ct. 774 (2023).

12. 547 U.S. 47 (2006).

Part IV.A analyzes the Eighth Circuit's decision and argues that the court should have read *Claiborne* as controlling. Part IV.B argues that the challenged law constitutes impermissible viewpoint discrimination and should have been struck down.

II. FACTS AND PROCEDURAL HISTORY

In 2017, the Arkansas General Assembly passed Act 710 ("the Act").[13] The Act prohibited state entities from contracting with any company or individual that failed to certify that they were not engaged and would not engage in a boycott of Israel throughout the life of the contract.[14] The law offered a carveout to companies that would offer to "provide the goods or services for at least twenty percent (20%) less than the lowest certifying business," or those with contracts with total potential values of less than $1,000.[15]

The Act defined "boycott Israel" and "boycott of Israel" to mean "engaging in refusals to deal, terminating business activities, or *other actions* that are intended to limit commercial relations with Israel, or persons or entities that are intended to limit commercial relations with Israel, or persons or entities doing business in Israel or in Israeli-controlled territories, in a discriminatory manner."[16]

The *Arkansas Times*, a weekly newspaper based in Little Rock, is published by Arkansas Times LP.[17] For many years, the paper contracted with Pulaski Technical College ("Pulaski Tech"), also in Little Rock, to run the school's paid advertisements in the print edition.[18] A few months before the passage of the Act, the school became part of the University of Arkansas system.[19] In October 2018, as Arkansas Times and Pulaski Tech prepared to enter new advertising contracts, the text of the Act brought the proceedings to a halt. Pulaski Tech informed Arkansas Times that, as a state entity, the school's ability to contract with the paper depended, in part, on the publisher's willingness to sign the certification mandated by the Act.[20] The publisher refused to either sign the certification or accept the twenty percent reduction in payment proffered by the Act.[21] By December, Arkansas Times had initiated a lawsuit against the members of the University of Arkansas Board of Trustees (UABT) and filed a motion for preliminary injunction.[22] The certification requirement of the Act, they argued, violated the First Amendment, unconstitutionally compelling speech, restricting

13. ARK. CODE. ANN. § 25-1-503 (West 2024); Katherine Hung, *Arkansas Passes Anti-BDS Law*, BRANDEIS CTR. (Apr. 3, 2017), https://brandeiscenter.com/arkansas-passes-anti-bds-law/ [https://perma.cc/SY65-VM7G].

14. § 25-1-503.

15. *Id.* § 25-1-503(b).

16. *Id.* § 25-1-502 (emphasis added).

17. Ark. Times LP v. Waldrip (*Waldrip II*), 988 F.3d 453, 460 (8th Cir. 2021), *aff'd en banc*, 37 F.4th 1386 (8th Cir. 2022), *cert. denied*, 143 S. Ct. 774 (2023).

18. *Id.*

19. *Id.* at 460.

20. *Id.*

21. *Id.*

22. Petition for Writ of Certiorari at 6, Ark. Times LP v. Waldrip, 143 S. Ct. 774 (2023) (No. 22-379).

participation in political boycotts, and discriminating based on subject matter and viewpoint.[23]

The Arkansas District Court denied the Arkansas Times's motion for a preliminary injunction and dismissed the case with prejudice.[24] The Act, in the court's view, did nothing to restrict any actions that the contractor might take other than their "purchasing activities with respect to Israel."[25] Even though the Act's definition of a boycott included both the refusal to deal with Israel and "other actions that are intended to limit commercial relations with Israel," the court did not construe "other actions" to include conduct with greater First Amendment protection—"criticism of Act 710 or Israel, calls to boycott Israel, or other types of speech."[26]

Proceeding from the finding that the Act only prohibited economic activity, the court looked to the Supreme Court's decisions in *FAIR*[27] and *Claiborne*.[28] *FAIR*, according to the Eighth Circuit, stood for the proposition that boycotts on their own were not constitutionally protected speech or inherently expressive conduct, because they required supplemental, explanatory speech to communicate the actual message of the boycott.[29] Further, the court concluded that to the extent *Claiborne* establishes a First Amendment right to boycott at all, it "does not include political boycotts directed towards foreign governments concerning issues that do not bear on any domestic legal interest."[30]

On appeal, a divided panel of the United States Court of Appeals for the Eighth Circuit reversed the district court.[31] Contrary to the district court's conclusion, the panel construed the statutory "other actions" to include constitutionally protected speech and association.[32] *Claiborne*, as read by the panel, had given First Amendment protection to actions like "promotion or compliance with unsanctioned boycotts, divestment from, or sanctions against Israel as part of its consideration in awarding grants and contracts," actions that the Arkansas General Assembly had specifically singled out for regulation in the text of the Act.[33] These findings guided the panel's reading of "other actions" and led to the conclusion that the Act impermissibly regulated protected speech.[34]

The Eighth Circuit granted an en banc rehearing.[35] Judge Kobes, who was the lone dissenter in the panel hearing, this time wrote the majority opinion overturning the

23. *Waldrip III*, 37 F.4th 1386, 1390 (8th Cir. 2022), *cert. denied*, 143 S. Ct. 774 (2023).

24. Ark. Times LP v. Waldrip (*Waldrip I*), 362 F. Supp. 3d 617 (E.D. Ark. 2019).

25. *Id.* at 623.

26. *Id.* (quoting ARK. CODE. ANN. § 25-1-502(1)(A)(i) (West 2024)).

27. 547 U.S. 47 (2006).

28. 458 U.S. 886 (1982); *Waldrip I*, 362 F. Supp. 3d at 623–24.

29. *Waldrip I*, 362 F. Supp. 3d at 624.

30. *Id.* at 625.

31. *Waldrip II*, 988 F.3d 453, 467 (8th Cir. 2021), *aff'd en banc*, 37 F.4th 1386 (8th Cir. 2022), *cert. denied*, 143 S. Ct. 774 (2023).

32. *Id.* at 465–66.

33. *Id.* at 465.

34. *Id.* at 466–67.

35. *Waldrip III*, 37 F.4th at 1390.

Waldrip II decision.[36] The circuit court affirmed the district court's order to deny the motion for a preliminary injunction and dismissed the case altogether.[37] The majority stated that "[t]he basic dispute in this case is whether 'boycotting Israel' only covers unexpressive commercial conduct, or whether it also prohibits protected expressive conduct."[38] Rather than reading *Claiborne* to protect actual boycott participation, the court saw a narrower scope, extending protections only to "expressive activities *accompanying* a boycott, rather than the purchasing decisions at the heart of a boycott."[39] With *Claiborne* deemed inapplicable to the actual economic decisions that created a boycott, the court turned to *FAIR*.[40] In the court's reading, the holding of *FAIR* limited First Amendment protection to conduct that a neutral observer would understand to be the expression of an idea.[41] Thus, the economic decisions at the heart of a boycott were not constitutionally protected, because a neutral observer would not infer expression from that conduct absent any explanatory speech.[42]

With those principles in mind, the court addressed the objection to the "other actions" provision.[43] "Other actions," in the court's eyes, restricted only commercial activities, in the same manner as "engaging in refusals to deal" and "terminating business activities."[44]

On February 21, 2023, the Supreme Court denied certiorari on an appeal by the Arkansas Times.[45]

III. PRIOR LAW

The Eighth Circuit is not the first U.S. court to rule on the issue of the anti-boycott laws, nor to address First Amendment protection for political boycotts more generally.[46] For decades, courts have tried to set the boundaries of that protection as they relate to the latter.[47] To understand the import of the decision in *Waldrip III*, context is necessary.

Part III.A contains a brief history of the BDS movement, what many scholars regard as "the most prominent organization today to promote a boycott and divestment campaign against Israel."[48] Part III.B begins with a brief explanation of anti-boycott

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36. *Id.*

37. *Id.*

38. *Id.* at 1391.

39. *Id.* at 1392.

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.* at 1393.

44. *Id.* at 1394 ("It does not ban Arkansas Times from publicly criticizing Israel, or even protesting the statute itself. It only prohibits economic decisions that discriminate against Israel.").

45. *See* Volokh, *supra* note 1.

46. *See infra* Part III.C.

47. *See infra* Part III.D.

48. *See* Marc A. Greendorfer, *The BDS Movement: That Which We Call a Foreign Boycott, by Any Other Name, Is Still Illegal*, 22 ROGER WILLIAMS U. L. REV. 1, 3–4 (2017) [hereinafter Greendorfer, *BDS Movement*]; *What Is BDS?*, BDS MOVEMENT [hereinafter BDS MOVEMENT], https://bdsmovement.net/what-is-bds [https://perma.cc/BK3A-E83E] (last visited Apr. 21, 2024) ("BDS is now a vibrant global

laws pertaining to Israel, at the federal level, before addressing the primary focus of this Note, the statutory and decisional landscape regarding anti-boycott laws pertaining to Israel at the state level. Next, Part III.C explores the major First Amendment decisions primarily relied upon by each party in *Waldrip III*—namely, *Claiborne*[49] and *FAIR*.[50] Part III.D provides the history of federal court decisions regarding laws substantially similar to the one at issue in *Waldrip III*.

A. The Boycott, Divestment, Sanctions Movement

The BDS movement was started in 2005, with the goal of forcing government action in Israel.[51] There is no single organizational body with "centralized decision-making and agency" with regards to the direction of the movement.[52] The words refer to boycotts of Israeli goods and services, calls to divest from Israeli companies, and advocacy for government sanctions against Israel.[53] The stated impetus of the movement is that "Israel is occupying and colonising Palestinian land, discriminating against Palestinian citizens of Israel and denying Palestinian refugees the right to return to their homes. It is maintaining a regime of occupation, settler colonialism and apartheid over the Palestinian people."[54]

The website for the BDS movement lists three specific demands: "Ending [Israel's] occupation and colonization of all Arab lands and dismantling the Wall [around Gaza]"; "[r]ecognizing the fundamental rights of the Arab-Palestinian citizens of Israel to full equality"; and "[r]especting, protecting and promoting the rights of Palestinian refugees to return to their homes and properties as stipulated in UN Resolution 194."[55]

Supporters of the movement and its strategy liken each to the global anti-apartheid movement wielded against South Africa in the late twentieth century.[56] On the economic front, companies that are based in Israel, contract with the Israeli military, or

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movement made up of unions, academic associations, churches and grassroots movements across the world."); David Halbfinger, Michael Wines & Steven Erlanger, *Is B.D.S. Anti-Semitic? A Closer Look at the Boycott Israel Campaign*, N.Y. TIMES (July 27, 2019), https://www.nytimes.com/2019/07/27/world/middleeast/bds-israel-boycott-antisemitic.html [https://perma.cc/H5R9-2NJX] ("With its adherents prominent in the British Labour Party and critics fighting it in Washington and dozens of state capitals, B.D.S. has become a proxy for the Israeli-Palestinian conflict in the United States and Europe, with all the emotion the conflict stirs.").

49. 458 U.S. 886 (1982).

50. 547 U.S. 47 (2006).

51. *See* BDS MOVEMENT, *supra* note 48.

52. *See, e.g.*, Timothy Cuffman, Note, *The State Power To Boycott a Boycott: The Thorny Constitutionality of State Anti-BDS Laws*, 57 COLUM. J. TRANSNAT'L L. 115, 122 (2018).

53. *Id.* at 122–24.

54. BDS MOVEMENT, *supra* note 48.

55. *Id.*

56. *The Boycott, Divestment and Sanctions Campaign (BDS)*, ANTI-DEFAMATION LEAGUE (May 24, 2022), https://www.adl.org/resources/glossary-term/boycott-divestment-and-sanctions-campaign-bds [https://perma.cc/DTU6-UWJP] ("They argue that the same boycott and isolation tactics used to help dismantle the South African White minority government should be used against Israel in order to force it to change its policies towards the Palestinians.").

otherwise interact with the country have been subjected to boycotts.[57] In addition to these economic aims, proponents have also sought to limit cultural and academic engagement with Israel by artists and scholars.[58]

Opponents of BDS have alleged that the movement, in substance and in practice, is anti-Semitic.[59] Focusing on the conduct of some of the more famous BDS participants and what they alleged to be undue scrutiny of the Israeli government, opponents of BDS often refer to the movement as a campaign dedicated to the destruction of Israel, violence against Israelis, and animus toward Jewish people in Israel and all over the world.[60]

BDS supporters deny the charge that they are motivated by anti-Semitism.[61] The BDS movement website explicitly denounces anti-Semitism and disputes the notion that Palestinians and their allies should be expected to focus their attention on abuses committed by countries other than Israel.[62] Many BDS supporters would characterize their movement as merely anti-Zionist, and not anti-Semitic.[63] However, many opponents of BDS have responded that to be anti-Zionist *is* to be anti-Semitic.[64]

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57. *See* Halbfinger et al., *supra* note 48.

58. *See id.*

59. *See id.*; Marc A. Greendorfer, *Boycotting the Boycotters: Turnabout Is Fair Play Under the Commerce Clause and the Unconstitutional Conditions Doctrine*, 40 CAMPBELL L. REV. 29, 48 (2018) [hereinafter Greendorfer, *Boycotting*] ("The BDS Movement was not only founded with the discriminatory goal of eliminating the State of Israel because of its Jewish nature, it has been promoted and supported by individuals and groups committed to the spread of hate and named as designated terror organizations by the United States.").

60. *See* Greendorfer, *Boycotting*, supra note 59, at 48; Tovah Lazaroff, *'BDS Movement Is Antisemitic,' British Home Secretary Says*, JERUSALEM POST (May 19, 2022, 8:54 PM), https://www.jpost.com/bds-threat/article-707088 [https://perma.cc/K4VH-EGT5] ("Everything we have seen around the BDS movement is racist . . . the antisemitic tropes, the cartoons, the chants [and] the flag-waving" (alteration in original) (quoting Priti Patel, Brit. Home Sec'y, Address to the Conservative Friends of Israel (May 16, 2022)); *see also* 165 Cong. Rec. H7182 (July 23, 2019) (statement of Rep. Eliot Engel) ("[H]ere is the thing about the global BDS movement: I don't believe it promotes racial justice or social change at all. It promotes a one-sided view of the Israeli-Palestinian conflict that seeks to marginalize Israel and that would deny the Jewish people the right to national self-determination . . . .").

61. *See* Arno Rosenfeld, *Leading Jewish Scholars Says BDS, One-State Solution Are Not Antisemitic*, FORWARD (Mar. 25, 2021), https://forward.com/news/466639/leading-jewish-scholars-say-bds-one-state-solution-are-not-antisemitic/ [https://perma.cc/9QRK-JPFA] ("Boycotting Israel and calling for an end to its Jewish majority is not inherently antisemitic, according to a new definition of antisemitism released Thursday by a group of more than 200 scholars of Jewish studies."); *see also, e.g.*, *Statement: Criticizing Israel Is Not anti-Semitic*, BDS AUSTL., https://bdsaustralia.net.au/about/not-antisemitic/ [https://perma.cc/N4WQ-Y6HH] (last visited Apr. 21, 2024).

62. *See* BDS MOVEMENT, *supra* note 48.

63. *See, e.g.*, *Our Approach to Zionism*, JEWISH VOICE FOR PEACE, https://www.jewishvoiceforpeace.org/zionism/ [https://perma.cc/6YAY-7XYR] (last visited Apr. 21, 2024) ("Through study and action, through deep relationship with Palestinians fighting for their own liberation, and through our own understanding of Jewish safety and self determination, we have come to see that Zionism was a false and failed answer to the desperately real question many of our ancestors faced of how to protect Jewish lives from murderous antisemitism in Europe."); Hadas Thier, *Anti-Zionism Is Not Anti-Semitism*, JACOBIN (Dec. 12, 2019), https://jacobin.com/2019/12/antisemitism-zionism-donald-trump-israel-palestine [https://perma.cc/A2SJ-MHXY].

64. *See, e.g.*, Isaac Chotiner, *Is Anti-Zionism Anti-Semitism?*, NEW YORKER (May 11, 2022), https://www.newyorker.com/news/q-and-a/is-anti-zionism-anti-semitism [https://perma.cc/D7JW-SYQK]

B. Statutory Landscape Regarding Boycotts of Israel

1. Federal Law

About fifteen years after the initiation of the Arab League boycott of Israel,[65] the U.S. government began its legislative response by amending the Mutual Security Act of 1954 with the Mutual Security Act of 1960.[66] The amended Act declared that the purposes of the 1954 law were "negated and the peace of the world is endangered when nations which receive assistance under this Act wage economic warfare against other nations assisted under this Act, including such procedures as boycotts."[67] More direct action was taken in 1977, when Congress passed amendments to the Export Administration Act (EAA), which sought to "prohibit compliance with or support of any foreign boycott against a country which is friendly to the United States, with specified exceptions."[68] The intended effect was to penalize companies that joined the Arab League boycott of Israel.[69] President Carter described the bill as intended "to end

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(quoting Anti-Defamation League director Jonathan Greenblatt as saying, "[I]f you peel back the layers in anti-Zionism, it is a historic form of delegitimization targeting Jews"); *Anti-Zionism and Anti-Semitism*, AM. JEWISH COMM. (October 2020), https://www.ajc.org/sites/default/files/pdf/2020-10/AntiZionism%20and%20 Antisemitism.pdf [https://perma.cc/64WP-ZCDY] ("The belief that the Jews, alone among the people of the world, do not have a right to self-determination—or that the Jewish people's religious and historical connection to Israel is invalid—is inherently bigoted.").

65. *See, e.g.*, Nancy Turck, *The Arab Boycott of Israel*, 55 FOREIGN AFFS. 472, 472 (1977) (describing the Arab League boycott as "an instrument . . . intended to prevent Arab states and discourage non-Arabs from directly or indirectly contributing to Israel's economic and military strength" in light of ongoing war and hostility); *see also Arab Economic Boycott*, ADL (Sept. 1, 2016), https://www.adl.org/resources/ glossary-term/arab-economic-boycott [https://perma.cc/F4CU-EXVD] ("The Arab Economic Boycott was initiated in 1946 by the newly formed League of Arab States. The boycott was aimed at preventing the continued growth of the Jewish community in Mandate-era Palestine by boycotting the goods and services produced by Jewish businesses.").

66. Pub. L. No. 86-472, 74 Stat. 134 (1960) (amending 22 U.S.C. § 1750) (repealed 1961).

67. *Id.* sec. 2, § 2, at 134; *see also Mutual Security Act of 1960: Hearings on HR 115-10 Before the Comm. on Foreign Affs.*, 86th Cong. 780, 780–82 ("Thus, one may hope that in a few years Israel will be in sight of economic balance. This advance would be much faster if Israel were not the victim of a declared war by her neighbors, *who disrupt her trade by boycotts and blockades. . . . It is disturbing to reflect that we, ourselves, have involuntarily become implicated in the Arab boycott*." (emphasis added) (statement of Rabbi Philip S. Bernstein, Chairman, American-Israel Pub. Affs. Comm.)).

68. 50 U.S.C. § 4607 (repealed 2018).

69. S. REP. NO. 95-104, at 16–19 (1978); Abrams v. Baylor Coll. of Med., 581 F. Supp. 1570, 1581 (S.D. Tex. 1984) (noting that Congress's concern regarding boycotts of Israel was the impetus behind the 1977 amendment to the EAA and that "the 'especial class' of persons to be protected by the EAA is comprised not only of Israelis but of American Jews as well"); Gilad Edelman, *Cuomo and B.D.S.: Can New York State Boycott a Boycott?*, NEW YORKER (June 16, 2016), https://www.newyorker.com/news/news-desk/cuomo-and-b-d-s-can-new-york-state-boycott-a-boycott [https://perma.cc/K975-B9UU]; *see also* Ben Cardin, *Setting the Record Straight: Nothing in the Israel Anti-Boycott Act Restricts Constitutionally-Protected Free Speech*, MEDIUM (July 20, 2017), https://medium.com/@SenatorBenCardin/setting-the-record-straight-nothing-in-the-the-israel-anti-boycott-act-restricts-constitutionally-13bfa7428d8 [https://perma.cc/EEV5-VDPD] ("Congress amended the Export Administration Act (EAA) in 1977 to prohibit U.S. persons from complying with unauthorized foreign boycotts—specifically, the Arab League Boycott of Israel . . . ."); *Office of Antiboycott Compliance*, DEP'T OF COM., https://www.bis.doc.gov/index.php/enforcement/oac [https://perma.cc/ 73WN-EEJ8] (last updated 2024) ("The Arab League boycott of Israel is the principal unsanctioned foreign boycott that U.S. persons must be concerned with today.").

the divisive effects on American life of foreign boycotts aimed at Jewish members of our society."[70]

According to the Department of Commerce, participation in the boycott included

- [a]greements to refuse or actual refusal to do business with or in Israel or with blacklisted companies;
- [a]greements to discriminate or actual discrimination against other persons based on race, religion, sex, national origin, or nationality;
- [a]greements to furnish or actual furnishing of information about business relationships with or in Israel or with blacklisted companies; and/or
- [a]greements to furnish or actual furnishing of information about the race, religion, sex, or national origin of another person.[71]

Since the passage of the EAA, the relevant provisions have "primarily persisted by way of a series of executive orders and/or presidential notices, pursuant to the President's power under the International Emergency Economic Powers Act."[72]

Many of the countries that once made up the Arab League no longer participate in the boycott, lessening its power.[73] Consequently, Congress has begun to focus its attention on the most prominent contemporary movement advocating for political and economic isolation of the State of Israel: the BDS movement.[74] In 2015, Congress passed the Trade Facilitation and Trade Enforcement Act.[75] It contains several provisions explicitly aimed at discouraging compliance with "actions by states, nonmember states of the United Nations, international organizations, or affiliated agencies of international organizations" to engage in "boycott of, divestment from, and sanctions against Israel."[76] Additionally, lawmakers have proposed bills like the Israel Anti-Boycott Act (IABA), a 2017 amendment to the EAA which sought to further

70. Presidential Statement on Signing H.R. 5840 into Law, 1 PUB. PAPERS 1136 (June 22, 1977).

71. MARTIN A. WEISS, CONG. RSCH. SERV., ARAB LEAGUE BOYCOTT OF ISRAEL 1 (2017). Former President Carter's justification for the law is emblematic of the enduring public debate on whether boycotts of Israel are inherently anti-Semitic. *See* Presidential Statement on Signing H.R. 5840 into Law, *supra* note 70 ("The bill seeks instead to end the divisive effects on American life of foreign boycott aimed at Jewish members of our society.").

72. *See* Cuffman, *supra* note 52, at 126. They have also recently reappeared in statute. *See* John S. McCain National Defense Authorization Act, Pub. L. No. 115-232, 132 Stat. 1636, sec. 1773, at 2234 (2019) (amending 50 U.S.C. § 4842) (containing the relevant language of the former EAA in the Anti-Boycott Act of 2018).

73. *See* WEISS, *supra* note 71, at 3.

74. *See, e.g.*, H.R. Res. 246, 116th Cong. (2109); Eric Cortellessa, *US House Overwhelmingly Passes Anti-BDS Resolution,* TIMES OF ISRAEL (July 24, 2019), https://www.timesofisrael.com/us-house-overwhelmingly-passes-anti-bds-resolution/ [https://perma.cc/GL8M-MVMS]. The American Israel Public Affair Committee said, "The resolution sends a powerful message that the House of Representatives explicitly rejects discrimination directed against the Jewish state through economic, cultural and political boycotts. Underscoring the House's solid pro-Israel position, the resolution was cosponsored by 350 representatives—strong majorities of both parties." *Id.*

75. 19 U.S.C. § 4452.

76. *Id.* § 4452(f)(1).

"counter the effects of actions to boycott, divest from, or sanction Israel."[77] The IABA, proposed by Senators Ben Cardin (D-Md.) and Rob Portman (R-Ohio), sought to declare that Congress "opposes the United Nations Human Rights Council resolution . . . which urges countries to pressure companies to divest from, or break contracts with, Israel."[78] It also sought to amend the EAA to impose civil and criminal penalties for, among other offenses, "support[ing] any boycott fostered or imposed by any international governmental organization against Israel or any request by any international governmental organization to impose such a boycott."[79] "International governmental organizations" included, but was not limited to, the United Nations and the European Union, but did *not* include civil society organization like the international BDS movement.[80] In an open letter to a prominent critic, Senator Cardin wrote that it was false to suggest that the bill would "prevent U.S. companies and individuals from expressing their points of view, speaking in favor of [BDS] activities, engaging in boycott activity of their own accord, or being critical of Israel."[81] The point became moot, as the bill died.[82]

The failure of the IABA was followed in the Senate by a more explicit bill: the Strengthening America's Security in the Middle East Act of 2019, which included the Combating BDS Act, a law which would have clarified that state anti-BDS laws would not be preempted by federal law.[83]

2. State Law

In 2016, then-Governor of New York Andrew Cuomo announced an executive order requiring all state entities to divest from any institution or company that was found to "participate in boycott, divestment or sanctions activity targeting Israel, either directly or through a parent or subsidiary."[84] The order declared that "the State of New York and Israel enjoy a special historical relationship and share a commonly forged cultural bond," and that the "State of New York unequivocally rejects the BDS campaign and stands firmly with Israel."[85] The executive order was summed up

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77. S. 720, 115th Cong., sec. 3(3) (2017) (amending 50 U.S.C. § 4602(5)); *see also Wielding Antidiscrimination Law To Suppress the Movement for Palestinian Rights*, 133 HARV. L. REV. 1360, 1364 (2020) [hereinafter *Wielding Antidiscrimination Law*].

78. S. 720, sec. 3(1).

79. *Id.* sec. 4(b), § 8(a)(1).

80. *Id.* sec. 6(a)(2).

81. *See* Cardin, *supra* note 69.

82. *100+ Groups Urge Congress To Stop Insertion of IABA in Omnibus Bill*, PALESTINE LEGAL (Dec. 5, 2018), https://palestinelegal.org/news/amended-unconstitutional-iaba [https://perma.cc/75BZ-RMC4] ("The IABA has failed to pass for two years . . . .").

83. S. 1, 116th Cong., tit. IV, § 402 (2019); Rubio reintroduced the Combating BDS Act as a standalone bill in 2023, *See* S. 1637, 118th Cong (2023). In 2019, the House also passed a resolution condemning BDS and "all efforts to delegitimize the State of Israel." *See* H.R. Res. 246, 116th Cong. (2019); *see also Wielding Antidiscrimination Law*, *supra* note 77, at 1364.

84. Exec. Order No. 157, N.Y. COMP. CODES R. & REGS. tit. 9, § 8.157 (West 2024).

85. *Id.*

succinctly in the headline to Cuomo's *Washington Post* op-ed announcing the order: "If you boycott Israel, New York state will boycott you."[86]

To those unfamiliar with the rancorous debates around the BDS movement, it may have come as a surprise that a liberal state like New York is one of dozens of states, "red" and "blue" alike, with laws like Act 710 on the books.[87] As of the writing of this Note, thirty-eight states "have adopted laws, executive orders, or resolutions designed to discourage boycotts against Israel."[88] These laws can be broadly dropped into three buckets: conditional state contracts, prohibitions on state investments, and coercive "defunding" laws.[89] The law at issue in *Waldrip III* concerns conditional state contracts.[90]

From Alabama, to Maryland, to Idaho, states have adopted laws that prohibit state and local governments from contracting with individuals and entities that engage in boycotts of Israeli companies.[91] In some states, the restrictions are not bound to Israel's

86. Andrew Cuomo, *If You Boycott Israel, New York State Will Boycott You*, WASH. POST (June 10, 2016), https://www.washingtonpost.com/opinions/gov-andrew-cuomo-if-you-boycott-israel-new-york-state-will-boycott-you/2016/06/10/1d6d3acc-2e62-11e6-9b37-42985f6a265c_story.html [https://perma.cc/Z4DZ-G4JE].

87. *Anti-Semitism: State Anti-BDS Legislation*, JEWISH VIRTUAL LIBR. https://www.jewishvirtuallibrary.org/anti-bds-legislation [https://perma.cc/N9U4-FMFZ] (last updated Feb., 2024).

88. *Id.*; *see also, e.g.*, 62 PA. STAT. AND CONS. STAT. ANN. §§ 3601–06 (West 2024) (targeting only anti-Israel boycotts in the "Prohibited Contracts Act"); *see, e.g.*, N.D. CENT. CODE ANN. § 54-44.4-15(2) (West 2024) ("A state entity that enters a contract that includes a provision prohibiting discrimination shall require the contract to include a provision prohibiting a party to the contract from boycotting Israel for the duration of the contract.").

89. *See Types of Legislation*, *supra* note 6. For examples of conditional state contract statutes, see FLA. STAT. ANN. § 287.135(2)(a) (West 2024) (making any company that is engaged in a broadly-defined boycott of Israel "ineligible" for a state contract), and KAN. STAT. ANN. § 75-3740f(b) (West 2024) "(The state may not adopt a procurement, investment or other policy that has the effect of inducing or requiring a person to boycott the government of Israel or its instrumentalities . . . ."). For examples of prohibitions on state investments, see 40 ILL. COMP. STAT. ANN. 5/1-110.16(d)(2) (compelling the state pension fund to divest from companies that boycott Israel), and COLO. REV. STAT. ANN. § 24-54.8-202(1)–(2) (West 2024) (prohibiting state investment by state retirement funds in companies that boycott Israel). For examples of coercive "defunding" legislation, see H.B. 998, 2014 Leg., Reg. Sess. (Md. 2014) (as introduced), and S.B. 647, 2014 Leg., Reg. Sess. (Md. 2014) (as introduced). *See Legislation: Maryland*, PALESTINE LEGAL, https://legislation.palestinelegal.org/location/maryland/ [https://perma.cc/6UMT-HS4X] (describing Maryland House Bill 998 and Senate Bill 647, which would have "imposed penalties on public higher education institutions that directly or indirectly provided funds to entities that supported academic boycotts" had they passed).

90. *See Waldrip III*, 37 F.4th 1386, 1390 (8th Cir. 2022) (en banc) ("In 2017, Arkansas passed a law requiring public contracts to include a certification that the contractor will not 'boycott' Israel. Arkansas Times sued, arguing that the law violates the First Amendment."), *cert. denied*, 143 S. Ct. 774 (2023).

91. ALA. CODE § 41-16-5(b) (West 2024) ("[A] governmental entity may not enter into a contract . . . with a business entity unless the contract includes a representation that the business entity is not currently engaged in, and an agreement that the business entity will not engage in, the boycott of a person or an entity based in or doing business with a jurisdiction with which this state can enjoy open trade."); Md. Exec. Order No. 01.01.2017.25 (Oct. 23, 2017) (establishing Maryland's conditional state contracts law, but clearly excluding noncommercial actions); IDAHO CODE ANN. § 67-2346 (West 2024) (announcing a similar law, but, like the Arkansas law, broadening the scope to prevent individuals and entities from taking "other actions that are intended to discriminate against, inflict economic harm, or otherwise limit commercial

internationally recognized borders, but also include disputed territories controlled by Israel.[92] Crucially, for those who wish to engage in pro-Palestinian advocacy, there is great variance in the scope of the prohibited activity.[93] As discussed in Section II, one of the two central disputes in *Waldrip III* was whether the phrase "other actions" encompasses pure political speech that falls squarely within the protections of the First Amendment.[94]

The standard structure of conditional state contract laws requires individuals or entities that seek to contract with the state to certify that they do not engage in boycotts of Israel, and will not do so through the duration of their contract.[95] In many cases, the individual or entity is asked to sign a certification attesting to the fact that they do not support or engage in boycotts of Israel, with attendant penalties for falsification in the initial certification or violation of the terms during the life of the contract.[96] In some states, such laws have been narrowed since their original passage, to exclude certain individuals and contracts that fall below a specific monetary threshold.[97]

There is some variance in the geographic scope of the prohibited boycott activity, which is relevant for those few who may object to, for example, products created in the West Bank, but not those within the internationally recognized borders of Israel.[98] But the crucial variation, the one at the heart of the challenged Arkansas law, comes in the

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relations specifically with the state of Israel or territories under its control, or persons or entities doing business in the state of Israel or territories under its control").

92. *See, e.g.*, IDAHO CODE ANN. § 67-2346; OHIO REV. CODE ANN. § 9.76; *see also* Cuffman, *supra* note 52, at 132 & nn.72–73 ("Four U.S. state laws merely apply to boycotts of 'Israel,' without specifying whether or not 'Israel' includes the West Bank, Gaza, and the Golan Heights. Fourteen states explicitly refer to boycotts of the 'territories controlled by Israel,' or some variant thereof, in addition to Israel itself, as conduct falling within the scope of the laws." (footnote omitted)).

93. Cuffman, *supra* note 52, at 130–31, 130 n.67, 131 n.68 ("[O]nly nine state laws explicitly mention 'divestment,' or some variant thereof, while only three state laws explicitly mention 'sanctions.'" (footnote omitted)).

94. *See supra* Section II; *Waldrip III*, 37 F.4th at 1395 (Kelly, J., dissenting) ("At issue in this case is the meaning of the third prong of the statutory definition of 'boycott of Israel': 'other actions that are intended to limit commercial relations with Israel, or persons or entities doing business in Israel or in Israeli-controlled territories,' 'in a discriminatory manner.'" (quoting ARK. CODE ANN. § 25-1-502(1)(A)(i) (West 2024))).

95. *See Types of Legislation*, *supra* note 6; *see also, e.g.*, FLA. STAT. ANN. § 287.135(2)(a) (West 2024); KAN. STAT. ANN. § 75-3740f(b) (West 2024).

96. *Types of Legislation*, *supra* note 6. The dissent in *Waldrip* argued that the legislature had not created a form certification, causing the state to draft its own for the Arkansas Times and other contractors to sign. *Waldrip III*, 37 F.4th at 1397 (Kelly, J., dissenting). The dissent noted that the form drafted by the State asked the Arkansas Times to "[agree] and [certify] that, as a contractor, it will not engage in a 'boycott of Israel' for the duration of its contract. But the certification does not define or even cite to the statutory definition of 'boycott of Israel.' Rather, a contractor is left to determine on its own what activity is or is not prohibited." *Id.* (citation omitted).

97. *See infra* note 176 and accompanying text.

98. *Compare* MINN. STAT. ANN. § 3.226 (West 2024) ("The legislature may not enter into a contract with a vendor that engages in discrimination against Israel, or against persons or entities doing business in Israel . . . ."), *with* TEX. GOV'T CODE ANN. § 808.001 (West 2024) ("'Boycott Israel' means refusing to deal with . . . a person or entity doing business in Israel or in an Israeli-controlled territory.").

form of the vague appendage “other actions,” which also appears in some other state laws.[99]

C. Major Supreme Court Decisions Relied Upon in Waldrip III

1. *NAACP v. Claiborne Hardware Co.*

In March 1966, a group of approximately five hundred Black citizens of Claiborne County, Mississippi approved a petition for the local government, entitled “Demands for Racial Justice.”[100] The demands, drafted by the local NAACP chapter and presented to Claiborne County, ranged from the legalistic to the social.[101] The citizens demanded the desegregation of all public schools, and an end to verbal abuse of Black people.[102] As noted in the Supreme Court decision, sixteen years later, the petitioners included a demand that Black people “are not to be addressed by terms as ‘boy,’ ‘girl,’ ‘shine,’ ‘uncle,’ or any other offensive term, but as ‘Mr.,’ ‘Mrs.,’ or ‘Miss,’ as is the case with other citizens.”[103] The NAACP chapter found the response of the local officials lacking and decided to take further action by initiating a boycott of white merchants in Port Gibson and elsewhere in Claiborne County.[104] In the first step of the boycott, Mississippi Action for Progress directed that all its federal funds marked for the purchase of food for children be spent only at Black-owned stores.[105] “[T]he consequences of this decision,” wrote Justice Stevens, “were significant.”[106]

From 1966 until 1970, the boycott of white businesses by the local NAACP chapter persisted, supported by picketing, public meetings, speeches, and public pleas.[107] At the same time, several incidents heightened the tension surrounding the boycott, including the murder of the Reverend Dr. Martin Luther King, Jr. and the shooting death of a Black man named Roosevelt Jackson by Port Gibson police officers.[108] Charles Evers, field secretary of the NAACP in Mississippi at the time, promised that Black community members who failed to comply with the boycott would be “disciplined.”[109] Claiborne County citizens testified to incidents of violence and threats of reprisal against such community members, including shots fired into the home of a Black couple who wanted to go to a white-owned dry cleaner.[110]

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99. *See, e.g.*, ARIZ. REV. STAT. ANN. § 35-393 (West 2024). Though the portions of this law that applied to sole proprietors, companies with fewer than ten employees, and contracts worth less than $100,000 were eventually struck down, “boycott” is still defined as “engaging in a refusal to deal, terminating business activities or performing *other actions* that are intended to limit commercial relations.” *Id.* (emphasis added); FLA. STAT. ANN. § 215.4725 (West 2024); NEV. REV. STAT. ANN. § 332.065(2) (West 2024).

100. NAACP v. Claiborne Hardware Co., 458 U.S. 886, 898–99 (1982).

101. *Id.* at 899.

102. *Id.*

103. *Id.* at 900.

104. *Id.*

105. *Id.* at 900–01.

106. *Id.* at 901

107. *Id.* at 902–04.

108. *Id.* at 901–02.

109. *Id.* at 902.

110. *Id.* at 905.

In 1969, seventeen white merchants filed suit against the NAACP, Mississippi Action for Progress, Inc., and 146 individuals, for their role in the boycott, seeking to recover losses sustained as a result of the boycott and to put a stop to any future boycott.[111] It was not until 1976 that a chancery court judge found the defendants liable for malicious interference and held that they had violated both a statutory prohibition on secondary boycotts and a Mississippi antitrust statute.[112] The defendants' claim that their conduct was permitted by the First Amendment was rejected, and the chancellor not only imposed damages on them, but entered a "broad permanent injunction" against any further boycott activity.[113] The Mississippi Supreme Court reversed a significant portion of this holding but upheld the imposition of liability, on the theory that "certain of the defendants, acting for all others, engaged in acts of physical force and violence against the persons and property of certain customers and prospective customers."[114] The "force, violence, and threats" that were a part of enforcing the boycott thus led the court to conclude that the *entire* boycott was unlawful, and that the "agreed use of illegal force, violence, and threats"—never established at trial—did not constitute speech protected by the First Amendment.[115]

The U.S. Supreme Court did not accept the claims of the plaintiff merchants and, sixteen years after the boycott commenced, found that the nonviolent elements of the boycott were entitled to First Amendment protection.[116] The Court engaged in a two-step inquiry.[117]

First, the Court considered the question of whether "petitioners' activities [were] protected in any respect by the Federal Constitution."[118] Looking to the "many forms" taken by the boycott, the Court began with the core of the boycott—the concerted economic effort to pressure white businesses—before moving to the speeches and picketing that accompanied the original act.[119] The Court stated: "As we so recently acknowledged in *Citizens Against Rent Control/Coalition for Fair Housing v. Berkeley*, 'the practice of persons sharing common views banding together to achieve a common end is deeply embedded in the American political process.'"[120] That some members of the boycott engaged in violent, unprotected conduct did not destroy constitutional protection for everyone else.[121] After analyzing each "element" of the boycott, the Court concluded that the boycott was an exercise of the "inseparable" First Amendment rights of "speech, assembly, association, and petition."[122]

The second step of the analysis was to determine whether Mississippi's interest in regulation of its own economic conditions was of sufficient weight to allow the state to

111. *Id.* at 889.
112. *Id.* at 891–92.
113. *Id.* at 892–93.
114. *Id.* at 894.
115. *Id.* at 895.
116. *Id.* at 933–34.
117. *See id.* at 907.
118. *Id.*
119. *Id.*
120. *Id.* (citation omitted) (quoting 454 U.S. 290, 294 (1984)).
121. *See id.* at 908.
122. *Id.* at 907–12.

regulate the speech of the boycotters.[123] Once again, the Court found the petitioners' arguments persuasive: "States have broad power to regulate economic activity," but they "do not [have] a comparable right to prohibit peaceful political activity such as that found in the boycott in this case."[124] In the Court's analysis, "[p]eaceful political activity," like that undertaken by the Black residents of Claiborne County, was distinct from economic activity designed to "destroy legitimate competition," which the state has greater power to regulate.[125] The Court held that the "nonviolent elements of [the boycott] [we]re entitled to the protection of the First Amendment."[126]

2. *Rumsfeld v. FAIR*

In 2003, FAIR, an association of law schools and their faculty, brought suit against the U.S. government over its enforcement of the Solomon Amendment.[127] The Solomon Amendment "prevented the Department of Defense (DOD) from providing specified federal funds to any institution of higher education 'that either prohibits, or in effect prevents' military recruiters 'from gaining entry to campuses.'"[128] FAIR, which sought to promote compliance with antidiscrimination policies of member schools, had fought versions of the Solomon Amendment for years.[129] The organization sought to restrict the access of military recruiters to students, in light of the then-extant congressional policy "with respect to homosexuals in the military."[130] After the September 11 terrorist attacks, the federal government pushed beyond the original language of the amendment, requiring universities to provide military recruiters "access to students equal in quality and scope to that provided to other recruiters."[131]

FAIR argued that this violated its First Amendment rights to speech and association, on many different grounds.[132] Most relevant to this Note, FAIR argued that compliance with the amendment would "significantly affect the law schools' ability to express their particular message or viewpoint."[133] The conduct required by the Solomon Amendment, FAIR argued, was inherently expressive, and if forced to allow

123. *Id.* at 912.

124. *Id.* at 913.

125. *Id.* at 914.

126. *Id.* at 915.

127. Rumsfeld v. FAIR, 547 U.S. 47, 52 (2006). The Solomon Amendment requires the Department of Defense, Department of Education, and other agencies to deny a university federal funding if it refuses to allow military recruiting on campus. 10 U.S.C. § 983.

128. *FAIR*, 547 U.S. at 52 (quoting 10 U.S.C. § 983(b)).

129. Linda Greenhouse, *U.S. Wins Ruling over Recruiting at Universities*, N.Y. TIMES (Mar. 7, 2006), https://www.nytimes.com/2006/03/07/politics/politicsspecial1/us-wins-ruling-over-recruiting-at-universities.html [https://perma.cc/8KX6-Z523] ("It was a setback, although hardly an unexpected one, to a coalition of law schools that brought the constitutional challenge, as well as to the Association of American Law Schools, which represents nearly all accredited law schools and since 1991 has required adherence to a nondiscrimination policy on sexual orientation as a condition of membership. Many law schools initially chose to comply with the association's policy by barring military recruiters . . . .").

130. *FAIR*, 547 U.S. at 52.

131. *Id.* at 53 (quoting FAIR v. Rumsfeld, 291 F. Supp. 2d 269, 283 (D.N.J. 2003), *rev'd*, 390 F.3d 219 (3d Cir. 2004), *cert. granted*, 125 S. Ct. 1977 (2005)).

132. *Id.*

133. *Id.* (quoting FAIR v. Rumsfeld, 291 F. Supp. 2d at 304).

the recruiters on campus, the schools could be viewed as communicating agreement with military policies.[134]

The Court rejected the argument that the challenged statute impermissibly regulated speech, stating "that high school students can appreciate the difference between speech a school sponsors and speech the school permits because legally required to do so, pursuant to an equal access policy."[135] However, the Court still considered whether the conduct was "inherently expressive."[136] This question was grounded in its *United States v. O'Brien* holding that First Amendment protections extended to forms of "symbolic speech"[137] where the conduct is "inherently expressive."[138]

The actions at issue, the Court concluded, were not expressively on par with, for example, burning an American flag.[139] Instead, an onlooker unaware of a law school's position on the military's policies would need supplementary speech to understand why the school was treating its recruiters differently from those of other organizations.[140] The Court asserted that it is not "overwhelmingly apparent" why a school would choose to do so.[141] The Court found "strong evidence that the conduct at issue [was] not so inherently expressive that it warrant[ed] protection under *O'Brien,*" because the act of treating those recruiters differently would not be easily understood to express anything in particular, let alone the actual reason for doing so.[142] Thus, in the view of the Court, the Solomon Amendment regulated mere unexpressive conduct, not speech, and was not subject to the *O'Brien* test.[143]

D. Federal District Court Decisions Concerning Laws Substantively Identical to Act 710

The cases discussed below reveal just a sample of the legislation aimed at boycotts like those at issue in *Waldrip III*. The cases examined here—*Koontz v. Watson*,[144] *Jordahl v. Brnovich*,[145] and *Amawi v. Pflugerville Independent School District*[146]—were resolved with opinions that provide the most clarity on issues in *Waldrip III*.[147] *Amawi* also serve as an introduction to viewpoint discrimination, which this paper argues should have been the controlling consideration in *Waldrip III*.

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134. *Id.* at 65.

135. *Id.*

136. *Id.* at 64.

137. 391 U.S. 367, 376 (1968).

138. *FAIR*, 547 U.S. at 66.

139. *Id.*

140. *Id.*

141. *Id.* (quoting Texas v. Johnson, 491 U.S. 397, 406 (1989)).

142. *Id.*

143. *See id.*

144. 283 F. Supp. 3d 1007 (D. Kan. 2018).

145. 336 F. Supp. 3d 1016 (D. Ariz. 2018), *vacated on other grounds*, 789 Fed. Appx. 589 (9th Cir. 2020).

146. 373 F. Supp. 3d 717 (W.D. Tex. 2019).

147. Though *Martin v. Wrigley*, 540 F. Supp. 3d 1220 (N.D. Ga. 2021), *Ali v. Hogan*, 26 F.4th 587 (4th Cir. 2022), and *Am. Muslims for Palestine v. Ariz. State Univ.*, No. CV-18-00670-PHX, 2018 U.S. Dist. LEXIS

1. *Koontz v. Watson*

In June 2017, Kansas enacted H.B. 2409,[148] requiring all state contractors to certify that they are not engaged in a boycott of Israel.[149] The law defined boycotts as

> engaging in a refusal to deal, terminating business activities or performing other actions that are intended to limit commercial relations with persons or entities doing business in Israel or in territories controlled by Israel, if those actions are taken either:
>
> (1) In compliance with or adherence to calls for a boycott of Israel other than those boycotts to which 50 U.S.C. § 4607(c) applies; or
>
> (2) in a manner that discriminates on the basis of nationality, national origin or religion, and that is not based on a valid business reason.[150]

Esther Koontz, a member of a Mennonite Church USA organization, began boycotting Israeli businesses that year, in recognition of the Mennonite Church USA resolution "calling on Mennonites to take steps to redress the injustice and violence that both Palestinians and Israelis have experienced."[151] Koontz was asked to sign a certification confirming that she was not participating in a boycott of Israel, prior to beginning work as a contracted teacher-trainer in a statewide program in Kansas.[152] Koontz refused to sign, and the program director instructed her that she could not be paid as a contractor until she signed the certification.[153] Koontz brought a Section 1983 claim against the Kansas Commissioner of Education, Randall Watson.[154]

In assessing the substance of Koontz's claim that state law had deprived her of a constitutional right, the court considered the unconstitutional conditions doctrine.[155] In *Pickering v. Board of Education*, the Supreme Court provided a test for determining whether a State had infringed on the First Amendment rights of a government employee, requiring courts to strike "a balance between the interests of the teacher, as a citizen, in commenting on matters of public concern and the interest of the State, as an employer, in promoting the efficiency of the public services it performs through its employees."[156] In *Board of County Commissioners v. Umbehr*, the Court extended *Pickering* to cover the speech rights of independent contractors with the government, holding that "independent contractors are protected, and that the *Pickering* balancing test, adjusted to weigh the government's interests as contractor rather than as employer,

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202068 (D. Ariz. Nov. 29, 2018) also concern challenges to anti-boycott laws, they are not discussed in this Note.

148. H.B. 2409, 2017 Leg., Reg. Sess. (Kan. 2017) (enacted).

149. Koontz v. Watson, 283 F. Supp. 3d 1007, 1013 (D. Kan. 2018) (citing KAN. STAT. ANN. § 75-3740f(a) (West 2024)).

150. H.B. 2409 (current version at KAN. STAT. ANN. § 75-3740e(a) (West 2024)).

151. *Koontz*, 283 F. Supp. 3d at 1013.

152. *Id.* at 1014.

153. *Id.*

154. 42 U.S.C. § 1983; *Koontz*, 283 F. Supp. 3d at 1012; Koontz v. Watson–*Challenge to Kansas Law Targeting Boycotts of Israel*, ACLU (Oct. 11, 2017), https://www.aclu.org/cases/koontz-v-watson-challenge-kansas-law-targeting-boycotts-israel [https://perma.cc/6M3X-2Y4S].

155. *Koontz*, 283 F. Supp. 3d at 1020.

156. 391 U.S. 563, 568 (1968).

determines the extent of their protection."[157] That test "requires [a] plaintiff to show, first, that the First Amendment protects the conduct that she claims led to the state denying a benefit."[158]

In the court's view, Koontz met this burden.[159] The court concluded that Koontz's actions fell under the protection identified in *Claiborne*—protection for the *specific elements* of the boycott, rather than protection only for the *right to participate* in a boycott.[160] These specific elements included meeting "with other likeminded individuals to organize and discuss the boycott," and supporting the boycott "with speeches, nonviolent picketing, and encouragement to others to join their cause."[161]

Applying the *Pickering* test to the Kansas law and relying on the ruling in *Claiborne*, the court found that "[t]he conduct prohibited by the Kansas Law is protected for the same reason as the boycotters' conduct in *Claiborne* was protected."[162] Having determined that the plaintiff met her burden, the court found the countervailing state interests lacking.[163] The compelling governmental interest was determined to be, quite simply, viewpoint discrimination.[164] As the court put it: "The Kansas Law's legislative history reveals that its goal is to undermine the message of those participating in a boycott of Israel."[165] Even the secondary interest in ensuring comfort for Israeli companies that conducted business in Kansas was held to be an impermissible goal.[166] "But even if one assumed," the opinion goes on,

> Kansas had passed the law to achieve constitutionally permissible goals that would not change the outcome here. It is still unconstitutional because it is not narrowly tailored to achieve those permissive goals. If Kansas had passed its law to regulate boycotts intended to suppress economic competition coming from Israel—a goal that *Claiborne* permits—the Kansas Law is overinclusive. It is overinclusive because it also bans political boycotts, which is impermissible.[167]

Crucial to any analysis of the law at issue in *Waldrip III* is the Kansas District Court's analysis of *Rumsfeld v. FAIR*.[168] The *Waldrip III* court understood the holding

157. 518 U.S. 668, 673 (1996).

158. *Koontz*, 283 F. Supp. 3d at 1021 (citing *Umbehr*, 518 U.S. at 675).

159. *Id.*

160. *Id.* (citing NAACP v. Claiborne Hardware Co., 458 U.S. 886, 907–08 (1982)).

161. *Id.* (citing *Claiborne*, 458 U.S. at 907).

162. *Id.* at 1022.

163. *Id.*

164. *Id.*

165. *Id.* at 1013, 1022. ("[L]egislators made statements during debate about the Kansas Law that its purpose was to stop people from antagonizing Israel.").

166. *Id.* at 1022 ("[T]he First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, or its content." (quoting Chi. Police Dep't v. Mosley, 408 U.S. 92, 95 (1972))).

167. *Id.* at 1023 (footnote omitted).

168. 547 U.S. 47, 66 (2006). As a principal case relied upon by the Eighth Circuit in deciding *Waldrip III*, past treatment of *FAIR* in litigation over laws substantially similar to the law at issue in *Waldrip III* is instructive. *See Waldrip III*, 37 F.4th 1386, 1391–94 (8th Cir. 2022) (en banc), *cert. denied*, 143 S. Ct. 774 (2023).

of *FAIR* to bar the regulation of inherently expressive conduct by state actors.[169] "Conduct is inherently expressive when someone understands that the conduct is expressing an idea without any spoken or written explanation."[170] The Kansas law, in the court's view, regulated conduct that was altogether different from the conduct in *FAIR*, and the court qualified it as inherently expressive.[171]

At first blush, this *Waldrip III* holding would appear to be conclusive on the Kansas law. If the act of boycotting Israel is inherently expressive conduct, then regulations aimed at that conduct are a violation of the First Amendment. But it is not so simple. The court in *Koontz* was terse in asserting that boycotting Israel is inherently expressive.[172] This underlines the difficulty at the heart of "inherently expressive conduct," as a doctrine. For the court, "[i]t is easy enough to associate the plaintiff's conduct with the message that the boycotters believe Israel should improve its treatment of Palestinians."[173] But the *Waldrip III* court did not spare one word to discuss the basis for that claim.[174] It did not cite studies on how widely this conduct would be understood to be political in nature, nor did it cite opinions of other courts on this conduct. The opinion included no support for the assertion that boycotting Israel is inherently expressive.[175] Far from being conclusive on this point, the court's ruling actually exposed a weak point in the argument: determining what is "inherently expressive" may depend in great part on whoever happens to be assessing that claim.

Koontz was one of several major federal district court cases regarding boycott laws like the one at issue in *Waldrip III*.[176] Each of these cases was eventually resolved in the same manner as *Koontz*: state legislatures, in response to defeats at district court, amended the laws to narrow the class of excluded person and organizations, rendering the claims of the original plaintiffs moot.[177]

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169. *Waldrip III*, 37 F.4th at 1392; *see also Koontz*, 283 F. Supp. 3d at 1023.

170. *Koontz*, 283 F. Supp. 3d at 1023 (citing *FAIR*, 547 U.S. at 65–66). The Supreme Court did not recognize the conduct at issue in *FAIR*—refusing to send emails and post notices on bulletin boards on behalf of the U.S. military—as inherently expressive, let alone as speech under constitutional protection. *See FAIR*, 547 U.S. at 66.

171. *Koontz*, 283 F. Supp. 3d at 1024.

172. *See id.*

173. *Id.*

174. *See Waldrip III*, 37 F.4th at 1393–94.

175. *See id.*

176. *See supra* notes 144–146.

177. *Compare* KAN. STAT. ANN. § 75-3740e(b), (c) (West 2017), *with* KAN. STAT. ANN. § 75-3740e(b), (c) (West 2024) (amending the law to remove sole proprietorships from the definition of "company" and adding a requirement that the contract be worth more than $100,000); Press Release, ACLU, After Court Defeat, Kansas Changes Law Aimed at Boycotts of Israel (June 29, 2018), https://www.aclu.org/press-releases/after-court-defeat-kansas-changes-law-aimed-boycotts-israel [https://perma.cc/U8EY-DBSM] (explaining that the amended version of the Kansas law no longer applies to sole proprietors or individuals and companies that conduct less than $100,000 worth of business in the state, and that the certification limits boycotts of Israeli goods and services "that constitute an integral part of business conducted or sought to be conducted with the state"); *compare* ARIZ. REV. STAT. ANN. § 35-393(2) (West 2016), *with* ARIZ. REV. STAT. ANN. § 35-393(2) (West 2024) (removing sole proprietorships from the definition of "company"); Jordahl v. Brnovich *(Amicus)*, CTR. FOR CONST. RTS. (Sep. 17, 2020), https://ccrjustice.org/home/what-we-do/our-cases/jordahl-v-brnovich-amicus [https://perma.cc/V4YS-3GD7] (explaining that "modifications to the Arizona law and its application to the plaintiff"—substantially similar to

2. *Jordahl v. Brnovich*

Jordahl v. Brnovich concerned an Arizona law that explicitly "aimed at divesting state funding from companies that engage in a boycott of Israel."[178] Arizona House Bill 2617 provided that

> [a] public entity may not enter into a contract with a company to acquire or dispose of services, supplies, information technology or construction unless the contract includes a written certification that the company is not currently engaged in, and agrees for the duration of the contract to not engage in, a boycott of Israel.[179]

Like the law in *Koontz*, the Arizona law in *Jordahl* included language that barred covered individuals and entities from "performing other actions that are intended to limit commercial relations with Israel."[180] Here, the sole proprietor who brought suit was Mikkel Jordahl, an Arizona lawyer who personally participated in a boycott of Israel.[181] Like Koontz, Jordahl was moved by the position of his church, the Evangelical Lutheran Church in America.[182] Jordahl also belonged to Jewish Voice for Peace (JVP), an organization that supports BDS.[183] He sought to support JVP with financial and legal resources at the same time as he worked as a government contractor, providing legal advice to prisoners in an Arizona county jail.[184]

In 2016, following the passage of the anti-boycott law, the county where Jordahl provided legal services asked Jordahl to sign a written certification that neither his firm nor any of its subsidiaries were "currently engaged in a boycott of Israel" nor would do so for the duration of the contract.[185] Jordahl signed the certification under protest, and later claimed that he turned down opportunities to provide services to organizations like JVP over the ensuing year, for fear he would run afoul of the certification requirement.[186] In 2017, he refused to sign the certification and the county refused to

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those made to the Kansas law and Koontz— "made the case moot."); *compare* TEX. GOV'T CODE ANN. § 808.001(2) (West 2024), *with* TEX. GOV'T CODE ANN. § 2271.001(2) (West 2024) (eliminating sole proprietorships from the definition of "company" despite the language remaining in the original statute); *see also* Amawi v. Paxton, 956 F.3d 816, 819 (5th Cir. 2020) ("[T]his appeal is moot because, twelve days after the district court's ruling, Texas enacted final legislation that exempts sole proprietors from the 'No Boycott of Israel' certification requirement.").

178. Jordahl v. Brnovich, 336 F. Supp. 3d 1016, 1028 (D. Ariz. 2018) (quoting *Fact Sheet for House Bill*, H.B. 2617, 52 Leg., 2d Sess., at 1 (Ariz. 2016) (enacted)), *vacated on other grounds*, 789 F. App'x 589 (9th Cir. 2020).

179. H.B. 2617, 52nd Leg., 2d Reg. Sess. (Ariz. 2016) (amending ARIZ. REV. STAT. ANN. § 35-393). The Arizona statute was amended in 2019 to change "boycott of Israel" to "boycott of *goods or services from* Israel." § 35-393.01(A) (emphasis added).

180. *Jordahl*, 336 F. Supp. 3d at 1028 (quoting § 35-393.01(A)).

181. *Id.*

182. *Id.*

183. *Id.* at 1029; *see also* Rob Gloster, *JVP Among 20 Groups Banned from Israel for BDS Support*, N. CAL. JEWISH NEWS (Jan. 8. 2018), https://jweekly.com/2018/01/08/jvp-among-20-groups-banned-israel-bds-support/ [https://perma.cc/ENT8-2Z6N].

184. *Jordahl*, 336 F. Supp. 3d at 1029.

185. *Id.*

186. *Id.*

pay him for his services.[187] Jordahl brought suit against the Arizona Attorney General, alleging that the anti-boycott law violated his First and Fourteenth Amendment rights.[188]

Jordahl argued that the certification constituted viewpoint and content discrimination and impermissibly compelled speech.[189] Further, he argued that those impositions were not justified by any legitimate government interests.[190] Arizona argued that the activities Jordahl wished to participate in were unexpressive commercial conduct, not entitled to First Amendment protection.[191] To the extent that such conduct was entitled to any protection, the State argued, it was decisively outweighed by the interests in regulating commercial activity and preventing discrimination on the basis of national origin.[192]

The court rejected the defendant's reliance on the Supreme Court's 1982 decision in *International Longshoremen's Ass'n v. Allied International, Inc.*,[193] and on the 1984 Seventh Circuit decision *Briggs & Stratton Corp. v. Baldrige*.[194] The court found that *Longshoremen*, establishing limits on First Amendment protections for economic boycotts, merely "highlight[ed] the context in which this type of governmental infringement on the First Amendment rights of labor unions and their members is justified."[195] *Claiborne*, decided by the Supreme Court just a few months after *Longshoremen*, provided the relevant law regarding the government's burden in infringing on such activity.[196] *Claiborne*, in the court's articulation, held that "*each* 'element[] of the boycott [was] a form of speech or conduct that is ordinarily entitled to protection under the First and Fourteenth Amendment.'"[197] The *Jordahl* court asserted that *Claiborne* "stands for the proposition that collective boycotting activities undertaken to achieve social, political or economic ends is conduct that is protected by the First Amendment."[198]

The court applied the *Claiborne* holding to the state law, as had occurred in *Koontz*.[199] Since "the practice of persons sharing common views banding together to achieve a common end is deeply embedded in the American political process," and the

187. *Id.*

188. *Id.* The court granted the state of Arizona's request to intervene for the purpose of defending the facial constitutionality of the law. *Id.* at 1030.

189. *Id.* at 1039.

190. *Id.*

191. *Id.*

192. *Id.*

193. 456 U.S. 212 (1982).

194. 728 F.2d 915 (7th Cir. 1984); *see also Jordahl*, 336 F. Supp. 3d at 1040 (first citing *Int'l Longshoremen*, 456 U.S. 212; and then citing *Briggs & Stratton Corp.*, 728 F.2d 915).

195. *Jordahl*, 336 F. Supp. 3d at 1041.

196. *Id.*

197. *Id.* (alterations in original) (emphasis added) (quoting NAACP v. Claiborne Hardware Co., 458 U.S. 886, 906 (1982)).

198. *Id.*

199. *Id.* at 1042 ("[W]hen a statute requires a company, in exchange for a government contract, to promise to refrain from engaging in certain actions that are taken in response to larger calls to action that the state opposes, the state is infringing on the very kind of expressive conduct at issue in *Claiborne*."); *see also* Koontz v. Watson, 283 F. Supp. 3d 1007, 1022 (D. Kan. 2018).

text of the Arizona law sought to restrict precisely that activity—Jordahl had a legitimate claim to First Amendment protection.[200] The court found that the law impermissibly restricted Jordahl's ability to engage in a collective endeavor to influence political change (i.e., his ability to engage in constitutionally protected speech).[201]

The *Jordahl* decision came in September 2018.[202] The following year, the Arizona legislature narrowed the application of the anti-boycott law "to exclude sole proprietors, companies with fewer than 10 employees, and contracts worth less than $100,000."[203]

3. *Amawi v. Pflugerville*

Amawi v. Pflugerville, unlike many of the anti-boycott cases discussed in this Note, received extensive coverage in mainstream media sources.[204] Bahia Amawi, a Palestinian-American speech pathologist working in a Texas school district, counted herself as a participant in BDS.[205] After nine years working with the school district, Amawi was asked to sign an addendum to her renewal contract certifying that she did not boycott Israel and would not do so during the term of her contract.[206]

In 2017, Texas enacted a bill prohibiting state entities from contracting with companies that boycott Israel.[207] Here, "boycott Israel" was defined as "refusing to deal with, terminating business activities with, or otherwise taking any action that is intended to penalize, inflict economic harm on, or limit commercial relations specifically with Israel, or with a person or entity doing business in Israel or in an Israeli-controlled territory."[208] The bill's sponsor, Representative Phil King, was fairly straightforward about the aims of the bill:

> First, as a Christian, my religious heritage is intrinsically linked to Israel and to the Jewish people. Second, as an American, our national security is

200. *Jordahl*, 336 F. Supp. 3d at 1041–42 (quoting *Claiborne*, 458 U.S. at 907).

201. *Id.* at 1042.

202. *See generally id.*

203. S.B. 1167, 54th Leg., 1st Reg. Sess. (Ariz. 2019) (enacted); ARIZ. REV. STAT. ANN. § 35-393(2) (West 2024) (removing "a sole proprietorship" from definition of "Company"); § 35-393.01(A) (adding "with a value of $100,000 or more" to "contract"); *see also Legislation: Arizona*, PALESTINE LEGAL, https://legislation.palestinelegal.org/location/arizona/#legislation-sb-1167-2 [https://perma.cc/7QAY-2DVP] (last updated Jan. 19, 2023).

204. 373 F. Supp. 3d 717, 731 (W.D. Tex. 2019), *vacated on other grounds sub nom*. Amawi v. Paxton, 956 F.3d 816 (5th Cir. 2020); *see also* Jacey Fortin, *She Wouldn't Promise Not To Boycott Israel, so a Texas School District Stopped Paying Her*, N.Y. TIMES (Dec. 19, 2018), https://www.nytimes.com/2018/12/19/us/speech-pathologist-texas-israel-oath.html [https://perma.cc/LJ2K-2HZA]; Glenn Greenwald, *A Texas Elementary School Speech Pathologist Refused To Sign a Pro-Israel Oath, Now Mandatory in Many States—so She Lost Her Job*, INTERCEPT (Dec. 17, 2018), https://theintercept.com/2018/12/17/israel-texas-anti-bds-law/ [https://perma.cc/Q25G-URMK].

205. *Amawi*, 373 F. Supp. 3d at 731. As the court noted, Amawi's participation in the boycott amounted to consumer decisions in her personal life like refraining from the purchase of Sabra-brand hummus because of its connections to Israel. *Id.* at 731–32.

206. *Id.* at 732.

207. *Id.* at 730–31 (quoting TEX. GOV'T CODE ANN. § 808.001 (West 2024)).

208. § 808.001.

> dependent in great part on a strong Israel, often our only friend in the Middle East. Third, as a Texas legislator, our state has a substantial Jewish population and this issue is important to them. Texans have historical ties and do a lot of business with Israel. Fourth, it's just the right thing to do.[209]

As a result of the alleged harm wrought upon her by the law, Amawi brought suit alongside several other plaintiffs alleging harm for their support of BDS under the law.[210] Before proceeding to any analysis of the plaintiffs' First Amendment challenges to the law, the court had to first determine whether the First Amendment even applied to the conduct.[211] The inquiry began with a rehash of the "dueling precedents,"[212] the rules expressed by *Claiborne* and *FAIR*, and concluded, once again, that *Claiborne* was the controlling case.[213] In *FAIR*, the Court "did not treat the . . . plaintiffs' conduct as a boycott: the word 'boycott' appears nowhere in the opinion, the decision to withhold patronage is not implicated, and *Claiborne* . . . is not discussed."[214] Thus, *FAIR* could not possibly control a decision regarding state contracts conditioned on disengagement or pledges to not engage in a political boycott.[215]

The majority in *Amawi* expressed the position that the *Claiborne* Court was specific in articulating First Amendment protections for *every* nonviolent element of a political boycott.[216] In *Claiborne*, those elements had included picketing; public meetings to further the cause of the boycott; and the particular act of boycotting—in that case, the decision to "withh[old] patronage from the white establishment of Claiborne County."[217] Texas, in its motion to dismiss in *Amawi*, had argued that the *Claiborne* Court had only offered First Amendment protections to a narrower range of elements within the NAACP boycott, *not* to "the act of refusing to buy from white merchants."[218] The court in *Amawi* was blunt on this point: "Texas is incorrect."[219]

Having concluded that *Claiborne* controlled the interpretation of the Texas statute at issue, the majority asserted that, nevertheless, boycotts of Israel were not protected speech.[220] The state rehashed the same argument made in *Jordahl* regarding *Briggs* and *Allied International*.[221] Texas argued that so-called secondary boycotts had already been excluded from First Amendment protection by the *Longshoremen* Court and that the decision in *Briggs*, allowing the federal government to prevent companies from responding to questionnaires sent by "Arab countries . . . engaged in a long-standing

209. *Amawi*, 373 F. Supp. 3d at 731; *see also* Aaron Howard, *Texas Rep To File Anti-BDS Bill*, PHILKING (Nov. 10, 2016), https://www.philking.com/2016/11/11/texas-rep-to-file-anti-bds-bill-by-aaron-howard/ [https://perma.cc/Q78T-9D73].

210. *Amawi*, 373 F. Supp. 3d at 732–35.

211. *Id.* at 742–43.

212. *Id.* at 743.

213. *Id.*

214. *Id.*

215. *See id.* at 743–45.

216. *Id.* at 744 (citing NAACP v. Claiborne Hardware Co., 458 U.S. 886, 915, 918 (1982)).

217. *Id.* (alteration in original) (quoting *Claiborne*, 458 U.S. at 918).

218. *Id.* (quoting Defendant Att'y Gen. Ken Paxton's Motion to Dismiss at 11, *Amawi*, 373 F. Supp. 3d 717 (Nos. 18-CV-1091, 18-CV-1100)).

219. *Id.*

220. *Id.* at 745.

221. *Id.*; *see also supra* notes 195–198.

trade boycott of Israel," was a permissible portion of the Export Administration Act.[222] As the court in *Amawi* was quick to conclude, these arguments are facially weak and irrelevant to the issues at hand.[223] After dispensing with one more particularly weak argument on the scope of *Claiborne*, the court reached its conclusion: political boycotts are protected speech, and none of the exceptions that Texas put forth applied to the speech in this case.[224] Having dispensed with all arguments to the contrary, the court was finally able to proceed to the plaintiffs' challenges to the statute.[225] The relevant challenge, in this case, was that the statute constituted impermissible content- and viewpoint-based restriction of protected speech.[226]

The court began its content- and viewpoint-based discrimination analysis by stating a key principle of First Amendment doctrine: "[T]he First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, or its content."[227] Speech regulations, which are presumptively unconstitutional,[228] are content-based "if the law applies to particular speech because of the topic discussed or the idea or message expressed."[229] Content-based speech laws may only be justified on the basis that they serve compelling state interests and are narrowly tailored to do so.[230]

Viewpoint discrimination describes government action to "impermissibly 'license one side of a debate' and 'create[ ] the possibility that the [government] is seeking to handicap the expression of particular ideas.'"[231] The Supreme Court has labeled viewpoint discrimination an "egregious form" of content discrimination.[232] The *Amawi* court quoted the Supreme Court's assertion that viewpoint-based regulations are "particularly pernicious."[233] Whereas the general category is often subject to strict scrutiny, "viewpoint discrimination is significantly worse, often leading to per se invalidation."[234]

With the settled precedent and principles in mind, the *Amawi* court found that Texas had impermissibly sought to license just one side of a high-temperature political debate and restrict the other.[235] As one plaintiff mentioned, no equivalent conditioning

222. *Amawi*, 373 F. Supp. 3d at 745–46 (omission in original) (quoting Briggs & Stratton Corp. v. Baldrige, 728 F.2d 915, 916 (7th Cir. 1984)).

223. *See id.* at 745–46 ("*Longshoremen* is the exception, not the rule. . . . *Briggs* is even less relevant.").

224. *Id.* at 746–47 ("There is no authority to support the notion that speech must be concerned with domestic affairs to enjoy constitutional protection; indeed, the Supreme Court has held just the opposite.").

225. *Id.* at 747.

226. *Id.*

227. *Id.* (quoting Chi. Police Dep't v. Mosley, 408 U.S. 92, 95 (1972)).

228. *Id.* (citing R.A.V. v. St. Paul, 505 U.S 377, 395 (1992)).

229. *Id.* (quoting Reed v. Town of Gilbert, 576 U.S. 155, 163 (2015)).

230. *Id.* (citing *Reed*, 576 U.S. at 163).

231. *Id.* at 748 (alterations in original) (citing *R.A.V.*, 505 U.S at 394).

232. Lackland H. Bloom, Jr., *The Rise of the Viewpoint Discrimination Principle*, 72 SMU L. REV. F. 20, 21 n.4 (2019) (quoting Rosenberger v. Rector of Univ. of Va., 515 U.S. 819, 829 (1995)).

233. *Amawi*, 373 F. Supp. 3d at 747 (quoting *R.A.V.*, 505 U.S at 430).

234. Bloom, *supra* note 232, at 21.

235. *Amawi*, 373 F. Supp. 3d at 751.

was placed on the contracts of individuals who boycotted *Palestinian* companies.[236] Contrary to the State's assertion, the court concluded that the government's ability to determine the content of its own speech did not extend so far as to allow it to control political boycotts by its contractors.[237] In the court's analysis, none of the proffered state interests—prohibiting national-origin discrimination, prohibiting state contractors from violating antidiscrimination principles, and aligning commerce with state policy—were served by the statute.[238] And even if they had been, according to the court, the statute was *still* too broad.[239]

Ultimately, the court concluded that the plaintiff's First Amendment claims were likely to succeed, as the bill constituted impermissible content- and viewpoint-based restrictions, imposed unconstitutional conditions on public employment, and compelled speech for an impermissible purpose.[240]

IV. Personal Analysis

The court in *Waldrip III* blessed an unconstitutional law. It did so by misstating, or outright ignoring, persuasive authority from lateral courts on the precise subject of anti-boycott provisions in government contracting and also misstated or ignored Supreme Court precedent on the strength of the state's power to restrict speech.[241] The Eighth Circuit was incorrect in holding that *Claiborne* only expressed protection for the elements of political boycotts more traditionally associated with speech and in excluding the actual act of boycotting from implicit protection.[242] And even if one were to accept the court's argument that *Claiborne* did not express protection for the actual act of boycotting, and that *FAIR* controlled, it would still be the case that (1) the court did not present thorough analysis of whether a boycott of Israel would be inherently expressive conduct and (2) the text of the statute and filings by the state make clear that the *legislature itself* considered boycotts of Israel to be inherently expressive.[243]

Part IV.A analyzes the holding of *Claiborne* and why it, and not *FAIR*, is the controlling case for consideration of political boycotts. Part IV.B applies the doctrine of viewpoint discrimination, discussed in the analysis of *Amawi* and *Jordahl*, to the facts of *Waldrip III*.

236. *Id.* at 747–48 (quoting Pluecker Motion for a Preliminary Injunction at 30, *Amawi,* 373 F. Supp. 3d 717 (Nos. 18-CV-1091, 18-CV-1100)).

237. *See id.* at 748 ("Here, however, no reasonable observer would attribute Plaintiffs' decisions to boycott Israel to the State of Texas, and Texas does not argue otherwise.").

238. *Id.* at 748–51.

239. *Id.* at 751 ("But even if Texas's stated interests were the actual interests advanced by the statute—and even if they were compelling—the Court finds that H.B. 89 still sweeps too broadly.").

240. *Id.* at 757–58.

241. *See Waldrip III*, 37 F.4th 1386, 1393 (8th Cir. 2022) (en banc) ("So this case turns on what Act 710 bans: protected boycott-related activity, or non-expressive commercial decisions?"), *cert. denied*, 143 S. Ct. 774 (2023). That quote misstates the holding of *Claiborne* by failing to understand that the commercial decisions in *Claiborne* were, in fact, the "protected boycott-related activity." *Id.*; *see also* NAACP v. Claiborne Hardware Co., 458 U.S. 886, 909–10, 929 (1982).

242. *Waldrip III*, 37 F.4th at 1392.

243. *See infra* notes 267–272.

A. Claiborne *Provided First Amendment Protection for Boycotts and Should Have Controlled Rather Than* FAIR

The fundamental question at the heart of *Waldrip III* is whether the *Claiborne* Court intended for the actual boycott—the collective action whereby people lawfully, peacefully withhold patronage in order to bring about political or social change—to be one of the "nonviolent elements" worthy of First Amendment protection.[244] Both the district court and the Eighth Circuit construed the *Claiborne* holding to apply only to the supplementary elements of the NAACP boycott more easily understood as "speech"—picketing, speechifying, and meetings.[245] That interpretation of *Claiborne*, though not completely without merit, does not withstand the weight of textual and decisional evidence for the opposite conclusion: that *Claiborne* declared boycotts themselves to be protected by the First Amendment. In this case, the Eighth Circuit panel had it right.

Further, *FAIR* clearly did not control. Proceeding from its erroneous reading of *Claiborne*, the court reasoned that a politically motivated consumer boycott is similarly not protected, "[b]ecause those commercial decisions are invisible to observers unless explained."[246] But if this reasoning were to be accepted, then each element of any protest activity would need to be analyzed with the *FAIR* test for inherently expressive conduct to receive First Amendment protection. To do so would subject protest actions like sit-ins or other forms of collective protest to a new, higher standard of protective review—a standard that these actions could not satisfy.

A close textual analysis of *Claiborne* reveals the missteps of the *Waldrip III* court, which failed to undertake much analysis of the words they cited.

The *Claiborne* Court explicitly analyzed the "petitioners' activities."[247] The first paragraph of that analysis began with a description of one of those activities: "The boycott of white merchants at issue in this case took many forms."[248] The phrase that concluded the transition paragraph, "petitioners' activities," was given meaning by the beginning of the paragraph that followed, with "the boycott of white merchants."[249] Thus far, it seems clear that "petitioners' activities" and "the boycott of white merchants" are one and the same, and "at issue" in *Claiborne*.[250] The Court continued to describe the launch of the boycott; its "acknowledged purpose;" and the supporting elements—speeches and nonviolent picketing, along with word-of-mouth encouragement.[251] The following paragraph began: "*Each of these elements* of the

244. *See Waldrip III*, 37 F.4th at 1392; *see also Claiborne*, 458 U.S. at 915.

245. *Waldrip III*, 37 F.4th at 1392 ("It then held that the boycott 'clearly involved constitutionally protected activity' and that '[e]ach of these elements of the boycott is a form of speech or conduct that is ordinarily entitled to protection under the First and Fourteenth Amendments.'" (alteration in original) (quoting *Claiborne*, 458 U.S. at 907, 911)).

246. *Id.* at 1394; *see also*, Petition for Writ of Certiorari, *supra* note 22, at 28 ("[W]alking and sitting in restaurants are not inherently expressive activities, but that has never justified denying them First Amendment protection.").

247. *Claiborne*, 458 U.S. at 907.

248. *Id.*

249. *Id.*

250. *See id.*

251. *Id.*

boycott is a form of speech or conduct that is ordinarily entitled to protection under the First and Fourteenth Amendments."[252] Here, the order was reversed; the content of the general word "each" was described prior to using the word.

"Each of these elements" should be read to include the boycott itself, alongside the supporting elements. The Court cited its own decision to emphasize that the protected activity was the collective expression of dissatisfaction with certain political or social facts:

> As we so recently acknowledged in *Citizens Against Rent Control/Coalition for Fair Housing* v. *Berkeley*, "the practice of persons sharing common views banding together to achieve a common end is deeply embedded in the American political process." . . . In emphasizing "the importance of freedom of association in guaranteeing the right of people to make their voices heard on public issues," we noted the words of Justice Harlan . . . :
>
> "Effective advocacy of both public and private points of view, particularly controversial ones, is undeniably enhanced by group association, as this Court has more than once recognized by remarking upon the close nexus between the freedoms of speech and assembly."[253]

It seems difficult to conclude that the *Citizens Against Rent Control* Court was not referring to boycotts when it described effective advocacy, enhanced by group association.

And yet, this is what Judge Kobes and the Eighth Circuit did in *Waldrip III*.[254] The majority, in applying the *Claiborne* phrase "took many forms," only included some of the forms specified in the opinion—picketing; speeches; and encouragement, "a form of speech or conduct that is ordinarily entitled to protection under the First and Fourteenth Amendments."[255] The court did not explain why it had ignored the other forms specified in *Claiborne*, specifically, the boycott itself and the meeting that launched the boycott. The *Waldrip III* majority held that the *Claiborne* Court "stopped short of declaring that a 'boycott' itself—that is, the refusal to purchase from a business—is protected by the First Amendment"[256] and that the Court had only granted protection to "peaceful political activity such as that found *in the boycott* in this case."[257] The distinction between "the boycott" and the "peaceful political activity found in the boycott," contrary to the court's assertion, was not intended to indicate a difference between the boycott itself and the accompanying speech, but rather between the violent and nonviolent elements of the boycott.

Successive courts considering First Amendment challenges to anti-boycott laws substantially similar to the one contemplated in *Waldrip III* have read *Claiborne* to

252. *Id.* (emphasis added).

253. *Id.* at 907–08 (citations omitted) (first quoting Citizens Against Rent Control/Coal. for Fair Hous. v. Berkeley, 4545 U.S. 290, 294 (1981); and then quoting NAACP v. Alabama *ex rel.* Patterson, 357 U.S. 449, 460 (1958)).

254. *Waldrip III*, 37 F.4th 1386, 1392 (8th Cir. 2022) (en banc) ("Contrary to Arkansas Times's argument, *Claiborne* only discussed protecting expressive activities *accompanying* a boycott, rather than the purchasing decisions at the heart of a boycott."), *cert. denied*, 143 S. Ct. 774 (2023).

255. *Id.* ("So *Claiborne* instructs us to examine the *elements* of a boycott to determine which activities are constitutionally protected.").

256. *Id.*

257. *Id.* (quoting *Claiborne*, 458 U.S. at 913).

stand for the proposition that the boycott itself is protected activity. In *Koontz*, the Kansas District Court held that the "[t]he First Amendment protects the right to participate in a boycott as the Supreme Court held explicitly in *NAACP v. Claiborne Hardware Co.*"[258] In *Jordahl*, the Arizona District Court held that "the Supreme Court in *Claiborne* expressly found that non-union boycotting activities aimed 'to bring about political, social and economic change' were protected activities under the First Amendment."[259] And in *Amawi*, the Texas Western District Court understood that one of the "nonviolent elements" protected by the *Claiborne* Court "was the petitioners' decision to 'withh[old] patronage from the white establishment of Claiborne County.'"[260]

These decisions were all made in the last five years and concerned laws that were textually and substantively similar to the law at issue in *Waldrip III*.[261] Of course, an appellate court is not bound by the decisions of district courts, and the existence of dominant interpretations and conclusions does not and should not foreclose the possibility or propriety of different ones. But the fact remains that the judges who found protection for boycotts showed their work. Their decisions are heavy with textual interpretation of *Claiborne*. The decision in *Waldrip III* includes nothing of the sort.

Finally, the Supreme Court, in subsequent decisions, has been even more clear on the contours of First Amendment protection for boycotts. In *FTC v. Superior Court Trial Lawyers Ass'n*, the Court considered whether defense lawyers who boycotted their Criminal Justice Act assignments in order to receive greater pay were engaging in an "unfair method of competition," in violation of the Federal Trade Commission Act.[262] The lawyers in that case claimed that the boycott was protected under *Claiborne*.[263] But the Court distinguished between the boycott in *Claiborne* and the lawyers' boycott.[264] Unfavorably contrasting the lawyers' boycott with the NAACP boycott, the Court declared that "[s]uch an economic boycott is well within the category that was expressly distinguished in the *Claiborne Hardware* opinion itself."[265] In the petition for certiorari, Arkansas Times argued, "*Superior Court Trial Lawyers Association* thus reaffirmed *Claiborne Hardware*'s fundamental distinction between 'economic boycotts,' which are subject to rational government regulation, and

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258. Koontz v. Watson, 283 F. Supp. 3d 1007, 1021 (D. Kan. 2018) (citing *Claiborne*, 458 U.S. at 907).

259. Jordahl v. Brnovich, 336 F. Supp. 3d 1016, 1041 (D. Ariz. 2018) (quoting *Claiborne*, 458 U.S. at 907), *vacated on other grounds*, 789 F. App'x 589 (9th Cir. 2020).

260. Amawi v. Pflugerville Indep. Sch. Dist., 373 F. Supp. 3d 717, 744 (W.D. Tex. 2019) (alteration in original) (quoting *Claiborne*, 458 U.S. at 918).

261. *Compare* ARIZ. REV. STAT. ANN. § 35-393 (West 2024), *and* TEX. GOV'T CODE ANN. §§ 808.001, 2271.001 (West 2024), *and* KAN. STAT. ANN. § 75-3740f (West 2024), *with* ARK. CODE ANN. § 25-1-503 (West 2024); *see also* Monika Chawla, *Third Federal Court Holds Anti-Boycott Law Is a Violation of First Amendment in* Amawi v. Pflugerville, VILL. L. REV. BLOG (July 20, 2020), https://www.villanovalawreview.com/post/562-third-federal-court-holds-anti-boycott-law-is-a-violation-of-first-amendment-in-amawi-v-plugerville [https://perma.cc/MBS3-E3N8] (discussing similarities among the laws, complaints, and defenses at issue in the three cases cited *supra* notes 258–260).

262. 493 U.S. 411, 418–19 (1990) (citing D.C. CODE §§ 11-2601–2609 (West 2024)); *see also* 15 U.S.C. § 45(a)(1).

263. *Super. Ct. Trial Lawyers Ass'n*, 493 U.S. at 419.

264. *Id.* at 427.

265. *Id.*

'peaceful, political activity such as that found in the [Mississippi] boycott,' which is 'entitled to constitutional protection.'"[266]

Absent any more substantive explanation to the contrary, the conclusion should have been obvious: *Claiborne* provides qualified protection to boycotts.

Even if we were to accept the *Waldrip III* court's argument that *Claiborne* did not provide protection for the actual act of boycotting and that *FAIR* controlled, since a boycott would be considered conduct, and not speech, the opinion is lacking, as the majority devoted very little space to discussion of *FAIR*. In *FAIR*, the Court spent significant time explaining its belief that the regulated conduct was ultimately unexpressive, and therefore undeserving of First Amendment protection.[267] To extend the same reasoning to boycotts intended to limit commercial relations with Israel, *Waldrip III* relied entirely on the assumptions that, for purely economic reasons, the Arkansas Legislature intended only to ban commercial decisions.[268] The opinion did not investigate what might have been implied in the Act by "discriminatory manner."[269] When it did deign to "acknowledge that one of the Act's six legislative findings suggest[ed] a broader purpose. . . . Arkansas Times's interpretation . . . [was] outweighed by the other findings, which evidence[d] a purely economic purpose."[270] Put more simply: *FAIR* could only control if one were to ignore the provisions of the Arkansas law that would be inconvenient to such a finding.

The interpretation proposed in this Note was available to the *Waldrip III* majority. The panel decision, as well as the dissent to the Eighth Circuit decision, dissected the text of the Act in great detail, which one would expect for a case that relied heavily on statutory interpretation.[271] Rather than weighing heavily in the State's favor by beginning with a presumption of constitutionality, as the majority did, the dissent focused on the words of the statute and the legislative intent.[272]

B. *The Challenged Statute Constitutes Impermissible Viewpoint Discrimination and Should Have Been Struck Down*

In *Waldrip III*, the court ignored the issue of viewpoint discrimination, a "particularly pernicious" form of content-based discrimination.[273] The court's failure to

266. Petition for Writ of Certiorari, *supra* note 22, at 20–21 (alteration in original) (quoting *Super. Ct. Trial Lawyers Ass'n*, 493 U.S. at 428 & n.12).

267. Rumsfeld v. FAIR, 547 U.S. 47, 66–68 (2006).

268. *Waldrip III*, 37 F.4th 1386, 1394 (8th Cir. 2022) (en banc), *cert. denied*, 143 S. Ct. 774 (2023).

269. ARK. CODE. ANN. § 25-1-502(1)(A)(i) (West 2024).

270. *Waldrip III*, 37 F.4th at 1394 n.2.

271. *See id.* at 1395 (Kelly, J., dissenting).

272. *Id.*

273. R.A.V. v. St. Paul, 505 U.S. 377, 430 (1992); *see also* Chi. Police Dep't v. Mosley, 408 U.S. 92, 95–96 (1972) (striking down a statute that prohibited all picketing unrelated to labor disputes near a school when school was in session). Justice Marshall cast the decision as a bulwark against impermissible government incursion into "our people['s] . . . right to express any thought, free from government censorship." *Id.* at 96; *see also* Carey v. Brown, 447 U.S. 455, 471 (1980) (invalidating an anti-picketing statute substantially similar to the statute in *Mosley*); Texas v. Johnson, 491 U.S. 397, 399 (1989) (striking down a Texas statute that made it a crime to desecrate a venerated political object, including a state or national flag). The plaintiff had burned an American flag during a political demonstration. *Id.* The following year, the Court even struck down a federal statute designed to prohibit the disrespectful desecration of the flag. United States v. Eichman, 496

consider the doctrine is evidenced most vividly by the fact that the phrase does not appear once in the opinion. Analysis of the doctrine's history would have led to the conclusion that the Arkansas law engaged in impermissible viewpoint discrimination, with no applicable exceptions, by regulating politically expressive conduct.

It is a longstanding principle of Supreme Court jurisprudence that, absent a few exceptions, "government has no power to restrict expression because of its message, its ideas, its subject matter, or its content."[274] Speech regulations, which are presumptively unconstitutional,[275] are content-based "if the law applies to particular speech because of the topic discussed or the idea or message expressed."[276] Viewpoint discrimination, a subset of content discrimination, occurs when government action impermissibly "license[s] one side of a debate."[277] Since at least 1972, the Supreme Court had laid the groundwork for overturning statutes as impermissibly viewpoint-based,[278] and the Court has continued to apply the doctrine with regularity. For example, in *Good News Club v. Milford Central School*, decided in 2001, the Court held that a school district which had permitted use of its facilities for civic and educational extracurricular activities had violated viewpoint discrimination principles in denying access for the purposes of Bible study.[279]

The *Waldrip III* court should have analyzed the Arkansas law under this doctrine. Peaceful boycotts are protected First Amendment speech,[280] and the government sought to restrict that speech based on the specific speaker's viewpoint, rather than with any facially neutral law. The text of the statute claimed that it intended only to further the state's economic and antidiscriminatory goals, but as in *Amawi*, the terms of the statute itself contradicted this claim.[281]

The Act defined "boycott Israel" and "boycott of Israel" as follows: "engaging in refusals to deal, terminating business activities or other actions that are intended to limit commercial relations with Israel, persons or entities that are intended to limit commercial relations with Israel, or persons or entities doing business in Israel or in Israeli-controlled territories, in a discriminatory manner."[282] This definition specifies a single point of view that will exclude an entity or individual from being able to obtain a government contract. The legislature chose to, as Justice Scalia wrote in *R.A.V.*, "license one side of a debate to fight freestyle."[283]

U.S. 310, 312 (1990). See Todd R. Tunstall, *The Flag Burning Debate*, 1 L. & SOC'Y REV. U. CAL. SANTA BARBARA 63, 63–69 (2002) for a historical account of the *Johnson* and *Eichman* decisions.

274. *See* Amawi v. Pflugerville Indep. Sch. Dist., 373 F. Supp. 3d 717, 747 (W.D. Tex. 2019) (quoting *Mosley*, 408 U.S. at 95).

275. *Id.* (citing *R.A.V.*, 505 U.S. at 395).

276. *Id.* (quoting Reed v. Town of Gilbert, 576 U.S. 155, 171 (2015)).

277. *Id.* (quoting *R.A.V.*, 505 U.S. at 392).

278. *See Mosley*, 408 U.S. at 92.

279. 533 U.S. 98, 120 (2001) ("When Milford denied the Good News Club access to the school's limited public forum on the ground that the Club was religious in nature, it discriminated against the Club because of its religious viewpoint in violation of the Free Speech Clause of the First Amendment.").

280. *See supra* Part III.A.

281. *See Amawi*, 373 F. Supp. 3d at 751.

282. ARK. CODE. ANN. § 25-1-502 (West 2024).

283. R.A.V. v. St. Paul, 505 U.S. 377, 392 (1992).

A state's interest in regulating economic activity and promoting a policy of antidiscrimination, though compelling, has never been qualified as compelling *enough* to permit viewpoint discrimination.[284] In *R.A.V.*, Justice Scalia concluded that even the interest in ensuring the "basic human rights of members of groups that have historically been subjected to discrimination" was not enough to overcome "[t]he existence of adequate content-neutral alternatives" to the challenged ordinance that would achieve the same goal.[285] "[T]he only interest distinctively served by the content limitation [in the case]," Justice Scalia wrote, "is that of displaying the city council's special hostility towards the particular biases thus singled out."[286]

What else could the Arkansas law reflect but the Arkansas legislature's hostility toward a particular point of view? The interests that the Arkansas legislature described in the legislative findings section of the law are not compelling enough to allow abridgement of First Amendment protections.[287] Rather than serving economic or antidiscrimination interests, the law evinces hostility toward a particular viewpoint. This finding is grounded primarily in the strength of the court's decisions prohibiting viewpoint discrimination, but also, in part, in the fact that the legislature did not seem to be clear on the interests it sought to pursue. The legislative findings described in the law emphasize that regulating the "discriminatory decisions" of the boycott was intended to achieve a goal that was at once economic and antidiscriminatory.[288] The *Waldrip III* majority then described the law as both "primarily" and "purely" economic, an outright contradiction.[289]

As the *Waldrip III* dissent noted, the final legislative finding indicated that "Arkansas seeks to implement the policy of 'examining a company's *promotion* or compliance with unsanctioned boycotts, divestment from, or sanctions against Israel as part of its consideration in awarding grants and contracts.'"[290] As the dissent noted, "By the express terms of the Act, Arkansas seeks not only to avoid contracting with companies that refuse to do business with Israel. It also seeks to avoid contracting with anyone who supports or promotes such activity."[291]

Whether or not the Act was intended to limit purely economic decisions is debatable, at best, and in reality, it is contradicted by the text of the statute itself. The Act describes an antidiscriminatory intent without defining what "discriminatory" or "antidiscriminatory" mean in this context. The text of the statute purports to make it more difficult for those seeking government contracts to take "other actions that are intended to limit commercial relations with Israel," without limiting the actions to

284. *Id.* at 395 ("We do not doubt that these interests are compelling, and that the ordinance can be said to promote them. But . . . [t]he existence of adequate content-neutral alternatives thus 'undercuts significantly' any defense of such a statute." (quoting Boos v. Barry, 485 US 312, 329 (1988))).

285. *Id.*

286. *Id.* at 396.

287. ARK. CODE. ANN. § 25-1-501 (West 2024).

288. The law only requires certification that the entity seeking a contract is not boycotting Israel "in a discriminatory manner." *See* § 25-1-502(1)(A)(i). This might be easier to justify if the statute defined "discriminatory manner," but it does not. *See id.*

289. *Waldrip III*, 37 F.4th 1386, 1393–94 (8th Cir. 2022) (en banc), *cert. denied*, 143 S. Ct. 774 (2023).

290. *Id.* at 1396 (Kelly, J., dissenting) (quoting § 25-1-501(6)).

291. *Id.* at 1396–97.

economic behavior.[292] The conclusion is unavoidable: the Act impermissibly regulates one viewpoint in a high-temperature political debate and should have been declared unconstitutional.

V. Conclusion

The Eighth Circuit's decision to uphold the Arkansas anti-boycott law has the potential to abrogate long-standing protections for political boycotts. In its deficient interpretation of *Claiborne*, application of *FAIR*, and refusal to truly scrutinize the legislative purposes of Act 710, the court failed to grant the protections of the First Amendment to those whose speech is threatened.

292. § 25-1-502(1)(A)(i).

TAXES ON REMOTE WORK ARE NOT EVEN REMOTELY WORKING: *ZILKA V. TAX REVIEW BOARD* AND ITS IMPLICATIONS ON STATE AND LOCAL TAXATION[*]

I. INTRODUCTION

The befuddling interplay of state income taxation schemes has been eloquently characterized by legal scholarship as "a mess."[1] State taxes involve fifty jurisdictions applying distinct rules and differing tax rates.[2] To add more complexity to this tangled web, many states also permit cities, counties, and municipalities to levy separate income taxes.[3] With multiple governmental entities sinking their teeth into the same bundle of earnings, individual taxpayers are often left feeling as though they are paying too much in taxes.[4]

Though the presence of state and local taxation is nothing new, what has become more pervasive since the onset of the COVID-19 pandemic is the situation in which a taxpayer lives in one state but their workplace is in another state.[5] When a taxpayer is employed outside the state of residence, they may owe income tax to multiple states and political subdivisions, in addition to taxes owed to the federal government.[6]

Though the Due Process Clause of the U.S. Constitution does not necessarily forbid multiple taxation of personal income, aspects of the Commerce Clause require many states to combat duplicative taxation by providing credits for the amount of tax paid to other states.[7] This practice essentially allows for apportionment of the taxes

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1. Kathryn L. Moore, *State and Local Taxation of Interstate and Foreign Commerce: The Second Best Solution*, 42 WAYNE L. REV. 1425, 1426 (1996) [hereinafter Moore, *The Second Best Solution*].

2. Kathryn L. Moore, *State and Local Taxation: When Will Congress Intervene?*, 23 J. LEGIS. 171, 173 (1997) [hereinafter Moore, *When Will Congress Intervene?*].

3. *See* CHRISTIANA K. MCFARLAND & CHRISTOPHER W. HOENE, NAT'L LEAGUE OF CITIES, CITIES AND STATE FISCAL STRUCTURE, 16 tbl.1A (2015), https://www.nlc.org/wp-content/uploads/2015/01/NLC_CSFS_Report_WEB.pdf [https://perma.cc/Y6RN-KJWB].

4. *See* Fred Backus, *Nearly Half of Americans Feel They Pay Too Much in Taxes, Particularly Conservatives*, CBS NEWS (Apr. 18, 2022, 8:01 AM), https://www.cbsnews.com/news/tax-pay-too-much-opinion-poll-2022-04-18/ [https://perma.cc/FY8K-GF9X].

5. *See* Bryan Robinson, *Remote Work Is Here To Stay and Will Increase into 2023, Experts Say*, FORBES (Feb. 1, 2022, 6:24 AM), https://www.forbes.com/sites/bryanrobinson/2022/02/01/remote-work-is-here-to-stay-and-will-increase-into-2023-experts-say [https://perma.cc/2CU5-HS7C].

6. *See, e.g.*, Zilka v. Tax Rev. Bd. (*Zilka II*), Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *1 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision); Comptroller of the Treasury v. Wynne, 575 U.S. 542, 545–47 (2015).

7. JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶ 20.10 (3d ed. 2022).

owed between the relevant states and localities, where an individual pays income tax first to the state where they earned the income (State A), and then, if the taxpayer's state of residence (State B) has a higher tax rate, they pay State B only the excess of State B's tax rate over that of State A.[8] Taxes owed to cities, counties, or municipalities in an interstate situation tend to operate similarly.[9]

In *Zilka v. Tax Review Board (Zilka II)*, the Commonwealth Court of Pennsylvania dealt with a complex, but likely commonplace, set of circumstances in which a taxpayer was a resident of Philadelphia but worked in Wilmington.[10] Though the taxpayer in the case—who owed income tax to four different taxing jurisdictions—had a tax bill greater than that of all her Philadelphia neighbors who worked in-state and greater than that of all her Wilmington coworkers who lived in Delaware, the court concluded that the tax scheme violated no constitutional principles.[11]

This Note begins by describing the facts and procedural history of *Zilka II* in Section II. Then, Section III examines the legal history of the dormant Commerce Clause and its intersection with state and local taxation. Section IV details the Commonwealth Court of Pennsylvania's decision and reasoning in the case.

Part V.A provides a critical analysis of the court's opinion, arguing that the court failed to sufficiently engage with the Commerce Clause issues presented in the case and misapplied the relevant Supreme Court precedent. Part V.B then argues that, even if the tax scheme at issue is constitutional, it has a number of defects from a tax policy perspective. Overall, this Note asserts that, despite the Supreme Court's silence on state income taxes and the fact that the ideal solution of uniformity is likely off the table, the *Zilka II* court failed to consider the constitutional and policy issues in the context of remote work.

II. FACTS & PROCEDURAL HISTORY

During the 2013–2016 tax years at issue, Diane Zilka (the "taxpayer") was a resident of Philadelphia, Pennsylvania, but worked in Wilmington, Delaware.[12] As a result, she owed taxes to four jurisdictions: (1) Pennsylvania, (2) Philadelphia, (3) Delaware, and (4) Wilmington.[13]

Pennsylvania permits residents who work out of state, and therefore owe taxes to another state, to claim the amount of tax paid to that other state as a credit to offset the taxpayer's Pennsylvania tax bill.[14] The taxpayer consequently claimed a credit for her Delaware tax (5%) to offset her Pennsylvania tax (3.07%).[15] Since Pennsylvania has a lower tax rate than Delaware, Pennsylvania only allowed the taxpayer to apply this

8. *Id.* at 22.
9. *Id.* at 22–23.
10. *Zilka II*, 2022 WL 67789, at *1.
11. *Id.* at *6–7.
12. *Id.* at *1.
13. *Id.*
14. *Id.*
15. *Id.*

credit to the extent of her Pennsylvania tax of 3.07%, creating 1.93% of taxes paid to Delaware but not permitted as a credit against the taxpayer's Pennsylvania taxes.[16]

In addition to claiming a credit for the amount of Wilmington tax paid (1.25%) to offset her Philadelphia tax (3.92%), the taxpayer attempted to claim a credit against her Philadelphia tax for the 1.93% unused credit that could not be applied at the state level.[17] The Philadelphia Department of Revenue allowed the taxpayer's credit for the 1.25% Wilmington tax to reduce her Philadelphia tax bill, but it prohibited the application of the 1.93% unused credit from her Delaware tax as a credit against her Philadelphia taxes.[18]

The taxpayer appealed the Philadelphia Department of Revenue's denial of the Delaware tax credit to the Tax Review Board of Philadelphia, claiming that she was entitled to this credit from Philadelphia, since she owed 1.93% more in taxes than other Philadelphia residents who work entirely in-state, solely by virtue of her interstate work.[19] She alleged that such a tax scheme resulted in an infringement on interstate commerce, in violation of the Commerce Clause of the U.S. Constitution.[20]

The Tax Review Board denied her appeal, and the Philadelphia County Court of Common Pleas affirmed.[21] On January 7, 2022, the Commonwealth Court of Pennsylvania affirmed the decision of the Court of Common Pleas, holding that Philadelphia's rejection of the taxpayer's credit did not amount to double taxation and, therefore, was not an unconstitutional hindrance on interstate commerce.[22] In July 2022, the taxpayer appealed the Commonwealth Court's decision to the Supreme Court of Pennsylvania, which held oral argument on March 7, 2023, and as of the writing of this Note, that is where the case is being adjudicated.[23]

III. PRIOR LAW

This Section covers the history of and developments in the law leading up to the decision in *Zilka II*.[24] Part III.A discusses the evolution of the dormant Commerce Clause in the Supreme Court's jurisprudence. Part III.B then outlines the intersection of dormant Commerce Clause principles and the multiple taxation doctrine. Part III.C walks through the development of the modern method for determining the constitutionality of state taxation schemes, as enunciated in the *Complete Auto Transit, Inc. v. Brady* test and expanded upon by subsequent case law. Finally, Part III.D

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. Zilka v. Tax Rev. Bd. (*Zilka I*), Nos. 02438, 02439, 1063 CD 2019, 1064 CD 2019, 2019 WL 4396294, at *7 (Pa. Ct. C.P. Aug. 28, 2019).

22. *Zilka II*, 2022 WL 67789, at *6–7.

23. Zilka v. Tax Rev. Bd. (*Zilka III*), Nos. 31 EAL 2022, 32 EAL 2022, 2022 WL 2439600, at *1 (Pa. July 5, 2022), 281 A.3d 1029 (unpublished table decision) (granting leave to appeal).

24. *Zilka II*, 2022 WL 67789, at *6.

describes the application of the *Complete Auto* test to a later Supreme Court case, which is of particular significance to the outcome in *Zilka II*.[25]

A. The Court's Regulation of the States' Power To Tax

To understand the interaction of state and local tax regimes, one must first understand where each governmental entity derives its power to tax.[26] Though the federal government needed the Sixteenth Amendment to levy an income tax on individual taxpayers,[27] states have always possessed the power to impose taxes on their citizens by virtue of the states' independent sovereignty.[28] Further, states can extend their power by permitting cities, counties, and municipalities to levy separate income taxes.[29]

For example, the City of Philadelphia derives its power to tax from the Commonwealth of Pennsylvania's Sterling Act.[30] More generally, cities and other political subdivisions are creatures of the state and derive their authority to tax from an explicit delegation by the state.[31]

However, when taxpayer challenges assert violations of the U.S. Constitution's Commerce Clause, courts have had to weigh in on the prerogative of states to determine whether a state or city tax passes constitutional muster.[32] The Commerce

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25. 430 U.S. 274, 279 (1977).

26. *See* HELLERSTEIN & HELLERSTEIN, *supra* note 7, ¶ 20.10, at 1.

27. U.S. CONST. amend. XVI ("The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.").

28. *See, e.g.*, McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 428 ("[T]he power of taxing the people and their property, is essential to the very existence of government, and may be legitimately exercised [by the states] on the objects to which it is applicable, to the utmost extent to which the government may chuse to carry it."); RUSSELL J. DAVIS, MARY ELLEN WEST, ELIZABETH M. BOSEK, SALLY J.T. NECHELES, CARALYN M. ROSS, ERIC C. SURETTE, ELIZABETH WILLIAMS & LISA A. ZAKOLSKI, TEXAS JURISPRUDENCE TAXATION § 8 (3d ed. 2022) ("The power of the state to impose taxes is an inherent governmental power."); Douglas v. City of Jeannette, 130 F.2d 652, 658 (3d Cir. 1942) (stating that "the taxing power" is a "power inherent in sovereignty"). *But cf.* Craig Green, *United/States: A Revolutionary History of American Statehood*, 119 MICH. L. REV. 1, 10, 41 (2020) (arguing that the states and the Union "were simultaneously created and mutually constitutive" due to "both layers of government [having been] interrelated in their joint and codependent legal struggles for existence").

29. *See* MCFARLAND & HOENE, *supra* note 3, at 16.

30. *See generally* 53 PA. STAT. AND CONS. STAT. ANN. § 15971 (West 2024) (delegating taxing power to the City of Philadelphia); First Class City Home Rule Act, *id.* §§ 13101–13157 (granting Philadelphia with the authority of local self-government). *See* Philadelphia Home Rule Charter § 1-100 (1951) (outlining Philadelphia's broad "powers and authority of local self-government").

31. *See* Mastrangelo v. Buckley, 250 A.2d 447, 452–53 (Pa. 1969) ("The power of taxation, in all forms and of whatever nature lies solely in the General Assembly of the Commonwealth acting under the aegis of our Constitution. Absent a grant or a delegation of the power to tax from the General Assembly, no municipality, including Philadelphia, a city of the first class, has *any* power or authority to levy, assess or collect taxes." (footnote omitted)).

32. *See, e.g.*, J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 321 (1938) (striking down Indiana's gross receipts tax as a Commerce Clause violation); Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434, 453–54 (1939) (striking down Washington's tax on business income conducted in state but shipped out of state as a Commerce Clause violation); Cent. Greyhound Lines, Inc., of N.Y. v. Mealey, 334 U.S. 653, 663–64 (1948)

Clause grants Congress the power "[t]o regulate Commerce . . . among the several States."[33] However, in contrast to the Constitution's affirmative grant of power to Congress, courts have interpreted the Commerce Clause to include a "negative aspect" that forbids state laws from unduly burdening "the interstate flow of articles of commerce."[34] This doctrine, known as the dormant Commerce Clause, "prevents the States from adopting protectionist measures and thus preserves a national market for goods and services."[35] The effect is that while the Commerce Clause authorizes Congress to regulate interstate commerce,[36] the dormant Commerce Clause prohibits the states from enacting laws that inhibit interstate commerce.[37] Even outside of the state taxation context, the history and application of the Commerce Clause and dormant Commerce Clause doctrines have not been straightforward.[38] The early roots of the dormant Commerce Clause may trace back to Chief Justice John Marshall's decision in *Gibbons v. Ogden*.[39] There, the Court found "great force" in the argument that inherent in the Constitution's grant to Congress of the power to regulate interstate commerce is the implied exclusion of "the action of all others that would perform the same operation on the same thing."[40]

However, subsequent compositions of the Supreme Court diverged from Chief Justice Marshall's approach.[41] In one instance, the Court even went so far as to say that if Congress can meddle in interstate commercial affairs that are reserved for the states, as prescribed by the Tenth Amendment,[42] "the power of the states over local matters may be eliminated, and thus our system of government be practically destroyed."[43]

It was not until the New Deal Court that the pendulum swung back, once again expanding the role of the federal government relative to that of the states, by implementing a more pragmatic, fact-oriented approach to congressional authority.[44]

(striking down New York's tax on a bus company's out-of-state receipts); Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 200 (1995) (upholding Oklahoma's sales tax on bus tickets between Oklahoma and other states since the tax was on the transaction that occurred in state, not on the out-of-state services).

33. U.S. CONST. art. I, § 8, cl. 3.

34. Or. Waste Sys., Inc. v. Dep't of Env't Quality, 511 U.S. 93, 98 (1994) (internal quotation mark omitted) (citing Wyoming v. Oklahoma, 502 U.S. 437, 454 (1992)).

35. Tenn. Wine & Spirits Retailers Ass'n v. Thomas, 139 S. Ct. 2449, 2459 (2019).

36. U.S. CONST. art. I, § 8, cl. 3.

37. *Tenn. Wine*, 139 S. Ct. at 2459.

38. *Id.* ("This interpretation, generally known as 'the dormant Commerce Clause,' has a long and complicated history.").

39. 22 U.S. (9 Wheat.) 1 (1824).

40. *Id.* at 209.

41. *See, e.g.*, Thurlow v. Massachusetts (License Cases), 46 U.S. (5 How.) 504, 578–79 (1847) ("[T]he mere grant of power to the general government cannot . . . be construed to be an absolute prohibition to the exercise of any power over the same subject by the States."), *overruled by* Leisy v. Hardin, 135 U.S. 100 (1890).

42. U.S. CONST. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.").

43. Hammer v. Dagenhart, 247 U.S. 251, 276 (1918), *overruled by* United States v. Darby, 312 U.S. 100 (1941).

44. *See* NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 29–30 (1937); *Darby*, 312 U.S. at 124; Wickard v. Filburn, 317 U.S. 111, 118–19, 128–29 (1942).

The Tenth Amendment was declared "but a truism," not an independent check on federal power over the states.[45] From that point forward, the Court began striking down state laws that committed the sin of economic protectionism and thereby unduly infringed on interstate commerce.[46]

B. The Dormant Commerce Clause and the Rise of the Multiple Taxation Doctrine

The Court's exercise of the dormant Commerce Clause in the scope of state taxation has been at least as convoluted as its application outside the taxation context.[47] In 1872, the Supreme Court first invalidated a state tax on freight transported in interstate commerce, on the grounds that it violated the Commerce Clause.[48] This led to a period of confusion among the states and lower courts, as the Supreme Court began categorizing and differentiating between "direct taxes," which impermissibly burdened interstate commerce, and "indirect taxes," which were permissible taxes on local activities.[49] Scholars criticized this approach as perpetuating "a discordance between form and substance," where "[n]ames were made to matter more than mathematics or economics."[50]

Following this perplexing era, in 1938, the Court supplanted this formalistic distinction with the "multiple taxation doctrine," as established in *Western Live Stock v. Bureau of Revenue*.[51] Under this approach, state taxes were deemed constitutionally impermissible if they subjected a taxpayer engaged in interstate commerce to the risk

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45. *Darby*, 312 U.S. at 124.

46. *See, e.g.*, Dean Milk Co. v. City of Madison, 340 U.S. 349, 356 (1951) (striking down a state law that was facially discriminatory against milk pasteurized outside of Madison due to the presence of other nondiscriminatory alternatives); City of Philadelphia v. New Jersey, 437 U.S. 617, 628 (1978) (striking down a facially discriminatory law prohibiting import of out-of-state waste absent legitimate local concerns incidental to treating out-of-staters differently than in-staters); W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 198–207 (1994) (striking down a facially neutral law imposing a tax on fluid milk, with the funds used to subsidize Massachusetts dairy farmers, since the purpose and effect of the scheme was protectionist); Tenn. Wine & Spirits Retailers Ass'n v. Thomas, 139 S. Ct. 2449, 2459, 2474–76 (2019) (striking down a facially discriminatory state law creating a residency requirement to sell liquor since the law was not narrowly tailored to a legitimate state interest). *But see* Emma Horne, *Eating High on the Humanely Raised Hog: State Bans on Selling Food Produced Using Cruel Animal Farming Methods Do Not Violate the Dormant Commerce Clause*, 107 CORNELL L. REV. 1137, 1151–52 (2022) (noting that the Supreme Court granted certiorari in *Nat'l Pork Producers Council v. Ross*, 6 F.4th 1021 (9th Cir. 2021), *cert. granted*, 142 S. Ct. 1413 (Mar. 28, 2022), a challenge invoking the dormant Commerce Clause, which may provide an opportunity for the Supreme Court to reverse course in its dormant Commerce Clause jurisprudence in the animal agribusiness space).

47. *See* Moore, *The Second Best Solution*, *supra* note 1, at 1437.

48. *In re* State Freight Tax, 82 U.S. (15 Wall.) 232, 281–82 (1872) ("Whatever, therefore, may be the true doctrine respecting the exclusiveness of the power vested in Congress to regulate commerce among the States, we regard it as established that no State can impose a tax upon freight transported from State to State, or upon the transporter because of such transportation."), *abrogated by* Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175 (1995).

49. Moore, *The Second Best Solution*, *supra* note 1, at 1438.

50. Thomas Reed Powell, *More Ado About Gross Receipts Taxes*, 60 HARV. L. REV. 501, 502–03 (1947).

51. 303 U.S. 250, 275 (1938); *see also* Bradley W. Joondeph, *The States' Multiple Taxation of Personal Income*, 71 CASE W. RSRV. L. REV. 121, 126 (2020).

of a duplicative tax burden that was not borne by a taxpayer who was not engaged in interstate commerce.[52] The Court held that states could not levy taxes

> of such a nature as to be capable in point of substance, of being imposed, or added to, with equal right by every state which the commerce touches, merely because interstate commerce is being done, so that without the protection of the commerce clause it would bear cumulative burdens not imposed on local commerce.[53]

The Court reasoned that multiple layers of tax on the same revenue "would spell the destruction of interstate commerce" and defeat the very purpose of the Commerce Clause.[54]

The Court first applied this principle in the 1938 case *J.D. Adams Manufacturing Co. v. Storen*.[55] The Court struck down an Indiana gross receipts tax on sales that constitute interstate commerce, on the grounds that the revenue could potentially be taxed both in the state of sale and in the state of manufacture.[56] The Court explained that "[i]nterstate commerce would thus be subjected to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids."[57]

Next, in *Gwin, White & Prince, Inc. v. Henneford*, the Court encountered Washington's state tax on all income from business conducted within the state but shipped to out-of-state customers.[58] There, the Court held that such a tax scheme violated the Commerce Clause.[59] The Court reasoned that the tax discriminated against interstate commerce merely by virtue of being conducted across states.[60] Thus it was burdened with multiple taxation, while not exposing local commerce to the same risk.[61]

Then, in *Central Greyhound Lines, Inc., of New York v. Mealey*, a taxpayer challenged New York's tax on the portion of a bus company's receipts earned from services provided out of state.[62] The Court held that the tax scheme violated the dormant Commerce Clause by imposing an unfair burden on interstate commerce, since the receipts were also subject to taxation by other states.[63]

Through these cases, the Court molded its multiple taxation doctrine to effectuate its view that "the Commerce Clause forbids the *risk*—not just the fact—of multiple taxation" for multistate taxpayers.[64] The amorphous and uncertain nature of the

52. Joondeph, *supra* note 51, at 126; Moore, *The Second Best Solution*, *supra* note 1, at 1439.
53. *W. Live Stock*, 303 U.S. at 255–56.
54. *Id.* at 256.
55. 304 U.S. 307, 314 (1938).
56. *Id.* at 311.
57. *Id.* (citing *W. Live Stock*, 303 U.S. at 255–56).
58. 305 U.S. 434, 436–37 (1939).
59. *Id.* at 439–40.
60. *Id.*
61. *Id.* at 439.
62. 334 U.S. 653, 654, 660 (1948).
63. *Id.* at 662.
64. WALTER HELLERSTEIN, STATE TAXATION ¶ 4.09[1][a] (3d ed. 2022) (emphasis added).

multiple taxation doctrine set the stage for the Court's later development of a more concrete, multifactor standard to promulgate its approach.[65]

C. *The Court Develops the Modern Test for Determining the Constitutionality of State Taxes*

Following the line of cases invoking the multiple taxation doctrine, the Court adopted a new standard, known as the *Complete Auto* test, to determine whether a state tax violates the dormant Commerce Clause.[66]

1. The *Complete Auto* Four-Prong Test

In *Complete Auto Transit, Inc. v. Brady*, a Mississippi motor carrier, which transported motor vehicles manufactured out of state to dealers within the state, sued for a refund of the sales tax charged by Mississippi.[67] The claim centered on whether a Mississippi sales tax on the privilege of conducting business in the state violated the Commerce Clause when applied to an interstate activity.[68]

In *Complete Auto*, the Court synthesized a number of its prior decisions to forge a path away from formalism and redirected toward pragmatism.[69] The Court also rejected some of its prior holdings, proclaiming that "a state tax on the 'privilege of doing business' is per se unconstitutional when it is applied to interstate commerce."[70] However, the *Complete Auto* Court's lasting impact was its articulation of a four-prong test to determine when a tax scheme should be sustained against a Commerce Clause challenge: (1) "the tax is applied to an activity with a substantial nexus with the taxing State," (2) the tax "is fairly apportioned," (3) the tax "does not discriminate against interstate commerce," and (4) the tax "is fairly related to the services provided by the State."[71]

On its face, the *Complete Auto* test was designed to address the dormant Commerce Clause's primary purpose of prohibiting discrimination against interstate

65. *See* Taylor Payne, *Not Completely Useless:* Complete Auto Transit *and State Taxation*, 34 W. MICH. U. T.M. COOLEY L. REV. 261, 262–63 (2018).

66. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

67. *Id.* at 276–77.

68. *Id.* at 277.

69. *Id.* at 279 (finding that the Court's jurisprudence "considered not the formal language of the tax statute but rather its practical effect"); Payne, *supra* note 65, at 279.

70. *Complete Auto*, 430 U.S. at 288–89 (overruling its prior decision in Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602, 603 (1951), in its holding that a privilege-of-doing-business tax is not a Commerce Clause violation merely because it applies to an activity in interstate commerce).

71. *Id.* at 279. The Supreme Court expanded the four-prong *Complete Auto* test into six prongs when evaluating challenges to taxing statutes affecting foreign commerce. *See* Japan Line, Ltd. v. Cnty. of Los Angeles, 441 U.S. 434, 451 (1979). The two additional prongs for foreign contexts are: (1) "whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation"; and (2) "whether the tax prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Id.* (quoting Michelin Tire Corp. v. Wages, 423 U.S. 276, 285 (1976)).

commerce.[72] Within the state taxation context, this burden most commonly appears in taxes that (1) are the product of economic protectionism or (2) cause duplicative taxation.[73] The *Complete Auto* test's third prong—nondiscrimination against interstate commerce—safeguards against economic protectionism, while its second prong—fair apportionment—protects against duplicative taxation.[74]

However, the *Complete Auto* Court—like the prior cases it sought to synthesize—did not provide much clarity regarding the application of the four factors.[75] Nonetheless, though *Complete Auto* lacked specificity, it served as a "catalyst for further tax litigation," providing subsequent courts with a springboard to refine each of the prongs and to shape the future of state taxation law.[76]

a. Substantial Nexus

The first prong of the *Complete Auto* test requires a substantial nexus between the levied tax and the taxing state.[77] In its initial application of the substantial nexus prong to subsequent cases, the Court broadly stated that there is a "fundamental requirement of both the Due Process and Commerce Clauses that there be 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.'"[78] Over time, the nexus requirement for the Due Process Clause and Commerce Clause became "one and the same for purposes of assessing the validity of state taxes."[79]

In 1992, the Court announced a major shift, in *Quill Corp. v. North Dakota*, bifurcating the substantial nexus requirement between Due Process Clause and Commerce Clause analyses.[80] The Court stated that, within the Commerce Clause context, the nexus requirement is informed by "structural concerns about the effects of state regulation on the national economy."[81] Whereas the Due Process Clause possesses a "minimum contacts" requirement as a way to ensure notice, the Commerce Clause's substantial nexus requirement acts as "a means for limiting state burdens on interstate commerce."[82]

The Court also refused to reject the bright-line rule of a physical presence requirement that a prior tax case, *National Bellas Hess, Inc. v. Department of Revenue*

72. Michael Fader, Comment, *May States Double Tax Their Residents' Incomes? The Dormant Commerce Clause in* Maryland State Comptroller of the Treasury v. Wynne, 68 TAX LAW. 367, 371 (2015).

73. *Id.*

74. *Id.*

75. Payne, *supra* note 65, at 281.

76. *Id.*

77. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

78. Allied-Signal, Inc. v. Dir., Div. of Tax'n, 504 U.S. 768, 777 (1992) (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–45 (1954)); Payne, *supra* note 65, at 282.

79. Payne, *supra* note 65, at 283 (quoting Pamela M. Krill, Note, Quill Corp. v. North Dakota*: Tax Nexus Under the Due Process and Commerce Clauses No Longer the Same*, 1993 WIS. L. REV. 1405, 1406).

80. 504 U.S. 298, 305–06 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

81. *Id.* at 312.

82. *Id.* at 313.

of Illinois, had articulated.[83] *Quill* imposed a more stringent requirement—now a state tax would have to fulfill the distinct nexus requirements of both the Due Process Clause and the Commerce Clause.[84]

However, after *Quill*, lower courts failed to consistently interpret the physical presence requirement for substantial nexus.[85] Some Justices on the Court had been critical of the decision in *Quill* for its failure "to reevaluate *Bellas Hess* not only in light of *Complete Auto* but also in view of the dramatic technological and social changes that had taken place in our increasingly interconnected economy."[86] As a result, the Court later overruled the physical presence requirement of *Quill* and *Bellas Hess*, particularly in light of the interconnectivity and virtual contacts afforded by modern e-commerce.[87]

b. Fair Apportionment

The second prong of the *Complete Auto* test requires that the tax be fairly apportioned.[88] The primary purpose for this analytical step is "to ensure that each State taxes only its fair share of an interstate transaction."[89] The fair apportionment prong draws its roots from the multiple taxation doctrine, since fair apportionment seeks to mitigate the possibility that one state will "exceed[] its fair share" of tax and then another state will tax that same share.[90]

In *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, the Court enunciated two subrequirements for the fair apportionment prong: (1) "internal consistency" and (2) "external consistency."[91] Under the internal consistency test, the Court must examine whether "the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear."[92] The goal is to verify that interstate commerce is not being disadvantaged relative to intrastate commerce.[93] Through this test, the Court can "isolate the effect of a defendant State's tax scheme."[94]

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83. 386 U.S. 753 (1967), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018); *Quill*, 504 U.S. at 317.

84. *Quill*, 504 U.S. at 313 ("[A] corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause.").

85. *See* Payne, *supra* note 65, at 285–86.

86. Direct Mktg. Ass'n v. Brohl, 575 U.S. 1, 16–17 (2015) (Kennedy, J., concurring).

87. *Wayfair*, 138 S. Ct. at 2095 ("Modern e-commerce does not align analytically with a test that relies on the sort of physical presence defined in *Quill*. . . . A virtual showroom can show far more inventory, in far more detail, and with greater opportunities for consumer and seller interaction than might be possible for local stores. Yet the continuous and pervasive virtual presence of retailers today is, under *Quill*, simply irrelevant. This Court should not maintain a rule that ignores these substantial virtual connections to the State.").

88. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

89. Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 184 (1995).

90. *Id.* at 184–85; *see also* W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 255–56 (1938).

91. 514 U.S. 175, 185 (1995).

92. *Id.*

93. *See id.*

94. Comptroller of the Treasury v. Wynne, 575 U.S. 542, 562 (2015).

By contrast, the external consistency test "looks not to the logical consequences of cloning, but to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State."[95] In other words, courts must "examine the in-state business activity which triggers the taxable event and the practical or economic effect of the tax on that interstate activity."[96]

c. Nondiscrimination Against Interstate Commerce

The third prong of the *Complete Auto* test prohibits a state's tax from discriminating against interstate commerce.[97] This prong essentially collapses a Commerce Clause analysis into the *Complete Auto* framework.[98] A tax cannot "provid[e] a direct commercial advantage to local businesses."[99] Within the domestic context, states are barred from discriminating against "commercial activity occurring outside the taxing State" for the benefit of local business and interests.[100]

In *American Trucking Associations, Inc. v. Scheiner*, Pennsylvania imposed a flat tax on trucks for the privilege of using its highways.[101] Though in-state trucks traveled many more miles on Pennsylvania roads than out-of-state trucks, out-of-state trucks incurred a cost per mile nearly five times greater than that borne by local trucks.[102] The Court held that based on its "practical effect[s]," the tax was facially discriminatory.[103] "[A] state tax that favors in-state business over out-of-state business for no other reason than the location of its business is prohibited by the Commerce Clause."[104]

In *Jefferson Lines*, where Oklahoma imposed a sales tax on the full price of bus tickets for travel between Oklahoma and other states, the Court distinguished the tax from the one imposed in *Scheiner*,[105] highlighting the fact that Oklahoma facilitated the "purchases of the services equally for intrastate and interstate travelers" and that all purchasers incurred the same tax rate on these purchases.[106] The Court held that the tax did not discriminate against interstate commerce, because it imposed the same duty on purchases of equivalent value "regardless of whether the purchase prompts interstate or only intrastate movement."[107]

95. *Jefferson Lines*, 514 U.S. at 185.

96. Goldberg v. Sweet, 488 U.S. 252, 262 (1989), *abrogated on other grounds by Wynne*, 575 U.S. 542.

97. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

98. Payne, *supra* note 65, at 288–89.

99. *Jefferson Lines*, 514 U.S. at 197 (quoting Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959), *superseded by statute*, 15 U.S.C. § 381).

100. *Id.*; Bos. Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 329, 335 (1977).

101. 483 U.S. 266, 269–71 (1987).

102. *Id.* at 276.

103. *Id.* at 285–86.

104. *Id.* at 286.

105. Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 198 (1995) (citing *Scheiner*, 483 U.S. at 286).

106. *Id.*

107. *Id.* at 199.

d. Fairly Related to the Services Provided by the State

The final prong of the *Complete Auto* test requires a tax to be "fairly related to the services provided by the State."[108] In 1981, in *Commonwealth Edison Co. v. Montana*, the Court alluded to the overlap between this prong and the first prong of the *Complete Auto* test, which requires a substantial nexus between the levied tax and the state imposing the tax.[109] However, the Court then proclaimed that beyond this "threshold requirement," the fourth prong "imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a 'just share of state tax burden.'"[110]

The dissent in *Edison* contended that the majority's interpretation rendered the fourth prong impotent, only requiring a state to levy a "proportional rather than a flat tax rate."[111] In 1989, in *Goldberg v. Sweet*, the Court reinforced the *Edison* majority precedent, declaring that the purpose of the fourth prong is "to ensure that a State's tax burden is not placed upon persons who do not benefit from services provided by the State."[112] This factor "focuses on the wide range of benefits provided to the taxpayer, not just the precise activity connected to the interstate activity at issue."[113]

Since *Edison* and *Goldberg*, no Supreme Court case has addressed a challenge to the fourth prong of the *Complete Auto* test,[114] and most federal appellate courts have largely collapsed the analysis of the first and fourth prongs, wherein nexus is the dispositive element.[115] The *Edison* dissent's warning regarding the "emasculat[ion]" of the fourth *Complete Auto* prong has perhaps come to fruition, since the "blending of . . . [the two] prongs renders challenges to both prongs indistinguishable where one cannot be attacked without the other."[116]

D. Application of the Complete Auto *Test in* Comptroller of the Treasury v. Wynne

In 2015, the Court, for the first time, explicitly held that the dormant Commerce Clause applies to a state's tax on *personal* income.[117] In *Comptroller of the Treasury v. Wynne*, taxpayers challenged Maryland's personal income tax, which consisted of both a state and a county income tax.[118] Residents could take a credit against the state tax for the amount of income tax paid to another jurisdiction for income earned there, but they

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108. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

109. 453 U.S. 609, 625–26 (1981).

110. *Id.* at 626 (quoting W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)).

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

112. 488 U.S. 252, 266–67 (1989) (citing *Commonwealth Edison*, 453 U.S. at 627), *abrogated on other grounds by* Comptroller of the Treasury v. Wynne, 575 U.S. 542, 555 (2015).

113. *Id.* at 267 (citing *Commonwealth Edison*, 453 U.S. at 627).

114. *See* Payne, *supra* note 65, at 291.

115. *See, e.g.*, Polychrome Int'l Corp. v. Krigger, 5 F.3d 1522, 1535–36 (3d Cir. 1993); CSX Transp., Inc. v. Ala. Dep't of Revenue, 888 F.3d 1163, 1183 (11th Cir. 2018).

116. *Commonwealth Edison*, 453 U.S. at 645 (Blackmun, J., dissenting); Payne, *supra* note 65, at 291.

117. *The Supreme Court, 2014 Term—Leading Cases*, 129 HARV. L. REV. 181, 181 (2015).

118. 575 U.S. 542, 545–46 (2015).

could not take a corresponding credit against the county tax.[119] Notably, both the state and county taxes were collected by the same entity—Maryland's Comptroller of the Treasury (i.e., the State).[120]

After articulating the history of the dormant Commerce Clause and the persistence of the multiple taxation doctrine,[121] the *Wynne* Court held that there should not be a distinction between taxes on gross receipts—like those taxes evaluated in *J.D. Adams*, *Gwin*, and *Central Greyhound*—and taxes on net income.[122] The Court also dismissed the petitioner's argument that dormant Commerce Clause principles should apply differently in cases involving corporations as compared to those involving individuals.[123] Further, the Court abrogated a portion of the dictum in *Goldberg* that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes," thus preserving a cause of action for in-state taxpayers.[124]

Additionally, in *Wynne*, the Court clarified the taxing power of a state with regard to the Due Process Clause as compared to the Commerce Clause.[125] The Due Process Clause, the Court explained, permits a state to tax "*all* the income of its residents, even income earned outside the taxing jurisdiction."[126] On the other hand, "while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause."[127]

The *Wynne* opinion also elaborated on the *Complete Auto* test, as expanded on in *Jefferson Lines*, particularly in the fair apportionment prong.[128] Specifically, the Court explained the structural analysis process of the internal consistency test, when used to determine whether a tax's identical application in every state would hinder interstate commerce relative to that conducted intrastate.[129] The Court reasoned that the internal consistency test permits courts to "isolate the effect" of an individual state's tax by allowing courts to

> distinguish between (1) tax schemes that inherently discriminate against interstate commerce without regard to the tax policies of other States, and (2) tax schemes that create disparate incentives to engage in interstate commerce

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119. *Id.* at 546.

120. *Id.*

121. *Id.* at 548–51.

122. *Id.* at 551–52; *see also* J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 308 (1938); Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434, 435 (1939); Cent. Greyhound Lines, Inc., of N.Y. v. Mealey, 334 U.S. 653, 654 (1948).

123. *Wynne*, 575 U.S. at 553–54.

124. *Id.* at 555; Goldberg v. Sweet, 488 U.S. 252, 266 (1989), *abrogated on other grounds by Wynne*, 575 U.S. at 555 ("State taxes are ordinarily paid by in-state businesses and consumers, yet if they discriminate against out-of-state products they are unconstitutional." (quoting W. Lynne Creamery, Inc. v. Healy, 512 U.S. 186, 203 (1994))).

125. *Wynne*, 575 U.S. at 556.

126. *Id.* (quoting Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 462–63 (1995)).

127. *Id.* (quoting Quill Corp. v. North Dakota, 504 U.S. 298, 305 (1992), *overruled by* South Dakota v. Wayfair, 138 S. Ct. 2080 (2018)).

128. *See id.* at 561–63.

129. *Id.* at 561–62.

> (and sometimes result in double taxation) only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes.[130]

The Court noted that the first category is largely an unconstitutional infringement on the dormant Commerce Clause, while the second likely passes constitutional muster.[131] Those cross-border tax schemes that fail the internal consistency test belong exclusively to the first category, since any interstate "tax disadvantage that remains after application of the [test] cannot be due to tax disparities but is instead attributable to the taxing State's discriminatory policies alone."[132]

The *Wynne* Court held that Maryland's tax scheme failed the internal consistency test, since the disparate treatment of interstate commerce was "not simply the result of its interaction with the taxing schemes of other States" but rather was "inherently discriminatory and operate[d] as a tariff."[133] Critically, the Court announced that, in applying the internal consistency test, Maryland's income tax scheme must be analyzed "*as a whole*."[134] Though Maryland labeled each tax distinctively—county tax and state tax—the Court noted that "[f]or Commerce Clause purposes, it is immaterial that Maryland assigns different labels . . . to these taxes" since they "must be considered as one."[135]

A state's labeling of its own taxes is not dispositive since granting weight to the labels would authorize the state to tax at discriminatory rates while hiding behind such designations.[136] Particularly in *Wynne*, where both the state and county taxes were collected by the same entity, the Court found that labels cannot be determinative, and that the scheme must be viewed in its entirety.[137] The Court concluded that Maryland could cure its system by permitting a credit, against both the state and county taxes, for taxes paid to other states and localities.[138]

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130. *Id.* at 562.

131. *Id.*

132. *Id.* at 563 (alteration in original) (footnote omitted) (internal quotation mark omitted) (quoting Ruth Mason, *Made in America for European Tax: The Internal Consistency Test*, 49 B.C. L. REV. 1277, 1310 (2008)).

133. *Id.* at 564–65. See HELLERSTEIN & HELLERSTEIN, *supra* note 7, for further explanation of why Maryland's tax scheme in *Wynne* failed the internal consistency test:

> If every state imposed a regime like Maryland's, a taxpayer who confined her activity to one state would pay a single tax on her income to the state where she was a resident and in which she earned the income. By contrast, the taxpayer who ventured across lines to earn her income would pay a double tax on such income, one to her state of residence and another to the state in which she earned the income.

Id. at 7.

134. *Wynne*, 575 U.S. at 564 n.8 (emphasis added).

135. *Id.*

136. *Id.*

137. *See id.*

138. *Id.* at 568.

IV. Court's Analysis

In 2022, in *Zilka v. Tax Review Board*, the Commonwealth Court of Pennsylvania affirmed the decision of the Court of Common Pleas, holding that Philadelphia's tax scheme does not violate the Commerce Clause.[139] Part IV.A traces the *Zilka II* court's depiction of the double taxation doctrine and its impact on the dormant Commerce Clause. Part IV.B outlines the court's application of the *Complete Auto* test to the facts of *Zilka*, specifically focusing on the fair apportionment and nondiscrimination prongs. Part IV.C then summarizes the court's contrast of the facts in *Zilka* to those in *Wynne*. Lastly, Part IV.D describes the *Zilka II* court's conclusion that Philadelphia's tax regime did not violate the dormant Commerce Clause.

A. Double Taxation Under the Commerce Clause

Judge Wojcik began the discussion by outlining the implications of the Commerce Clause and dormant Commerce Clause when applied to a state's tax scheme.[140] The court highlighted that a state is forbidden from taxing an activity more heavily when it is interstate rather than intrastate, nor can a state discriminate against interstate commerce by benefiting local business at the expense of cross-state business.[141] The court stated that, "[i]n short, the Commerce Clause forbids double taxation."[142]

The court then attempted to apply the double taxation principle, concluding that the taxpayer was not subjected to duplicative taxation.[143] Judge Wojcik reasoned that Philadelphia's tax did not tax income crossing state lines more heavily than income generated entirely within Pennsylvania, since all residents, including the taxpayer, were paying the same 3.92% rate.[144] The court then advanced that while this taxpayer was paying 1.93% more in taxes than those who only worked intrastate, her increased tax burden resulted "because [she] chose to work in Delaware, *which charges a higher income tax than Pennsylvania*."[145] Philadelphia permitted Zilka to take a credit for taxes paid to Wilmington, and Pennsylvania did the same for taxes she had paid to the State of Delaware.[146] But the court determined that Philadelphia's refusal to apply the remaining unused credit of incremental Delaware tax that exceeded the Pennsylvania tax did not constitute double taxation in violation of the Commerce Clause.[147]

139. *Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, *6–7 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision).

140. *Id.* at *2.

141. *Id.* (citing Comptroller of the Treasury v. Wynne, 575 U.S. 542, 549–50 (2015)).

142. *Id.* (citing *Wynne*, 575 U.S. at 550–51).

143. *Id.* at *3.

144. *Id.*

145. *Id.*

146. *Id.* at *6.

147. *Id.*

B. *Application of the* Complete Auto *Test*

The *Zilka II* court applied the *Complete Auto* test to determine whether Philadelphia's tax scheme infringed on the restrictions of the dormant Commerce Clause.[148] The court only focused on the second and third prongs—fair apportionment and discrimination—since the parties did not dispute the first and fourth prongs.[149]

1. Fair Apportionment Prong

In its analysis of the *Complete Auto* test second prong—fair apportionment[150]—the *Zilka II* court explained that it "ensures that each State taxes only its fair share of an interstate transaction."[151] To apply this fair apportionment requirement, the court sought to determine whether Philadelphia's tax was both internally and externally consistent.[152]

a. Internal Consistency Test

When applying the internal consistency test, the court "look[ed] to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate."[153] Judge Wojcik established that the dormant Commerce Clause is not violated when different jurisdictions apply distinct tax formulas and rates, as long as "the alleged taxation disparities are 'the consequence of the combined effect' of two otherwise lawful income tax schemes."[154] Though employing uniformity in each jurisdiction's tax laws would certainly be sufficient to ensure the Commerce Clause's policy of having fairly apportioned and nondiscriminatory tax schemes, such a solution is not necessary.[155]

The *Zilka II* court concluded its internal consistency evaluation by finding that if every jurisdiction imposed a tax identical to that of Philadelphia, it would create the result that taxpayers living in Philadelphia but earning their income outside of Pennsylvania would be able to claim a credit for taxes paid to another jurisdiction and thus would pay the same amount as Philadelphians working entirely within the state.[156] The court held that Philadelphia's tax scheme was internally consistent, because Zilka's incremental tax owed was the natural consequence of her working in another state with a higher tax rate.[157] This determination rested on the court's view that the United States

148. *Id.* at *3–4.

149. *See id.* at *3; *Zilka I*, Nos. 02438, 02439, 1063 CD 2019, 1064 CD 2019, 2019 WL 4396294 (Pa. Ct. C.P. Aug. 28, 2019) ("Appellant appears to only be arguing that the Philadelphia wage tax system violates the 2nd and 3rd prong of the above referenced test.").

150. *Zilka II*, 2022 WL 67789, at *3–4.

151. *Id.* at *3 (quoting Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 184 (1995)).

152. *Id.* (citing *Jefferson Lines*, 514 U.S. at 185).

153. *Id.* (quoting Comptroller of the Treasury v. Wynne, 575 U.S. 542, 562 (2015)).

154. *Id.* (quoting Moorman Mfg. Co. v. Bair, 437 U.S. 267, 277 n.12 (1978)).

155. *Id.* (citing *Moorman Mfg.*, 437 U.S. at 279).

156. *Id.* at *4.

157. *Id.* at *3–4.

Supreme Court has often deemed a tax internally consistent when the taxing jurisdiction permits a credit to offset the amount a taxpayer has already paid to another jurisdiction.[158]

b. External Consistency Test

The court also applied the external consistency test, which looks at "the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State."[159]

The court determined that, since Philadelphia provided a credit for the tax Zilka had paid to Wilmington, the City was "not taxing all of Taxpayer's income regardless of source."[160] The court also found that Philadelphia's tax on the taxpayer's out-of-state income was justified by the administration of benefits and services to its residents.[161] The court held that Philadelphia's tax passed the external consistency test.[162]

2. Nondiscrimination Prong

The *Zilka II* court also examined the third prong of the *Complete Auto* test—that a state cannot levy a tax that discriminates against interstate commerce and favors intrastate activity.[163] Applying this standard, the court determined that Philadelphia's tax scheme did not discriminate against taxpayers with out-of-state income.[164] Judge Wojcik reasoned that the City taxed all residents at the rate of 3.92%, while permitting them to credit "any similar taxes paid to other jurisdictions."[165] In light of Zilka's ability to credit the full 1.25% paid to Wilmington against her Philadelphia tax liability, Judge Wojcik reasoned that the tax scheme merely apportioned Zilka's 3.92% tax rate between the two jurisdictions—2.67% paid to Philadelphia and 1.25% paid to Wilmington.[166] Therefore, it did not subject her income to double taxation.[167] The court did not mention Zilka's argument that her unused state-level tax credit should be allowed as a credit against her Philadelphia tax.[168]

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158. *Id.* at *3.

159. *Id.* at *4 (quoting Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995)).

160. *Id.*

161. *Id.* (citing Lawrence v. State Tax Comm'n, 286 U.S. 276, 279 (1932)).

162. *Id.*

163. *Id.* (first citing Comptroller of the Treasury v. Wynne, 575 U.S. 542, 549–50 (2015); and then citing *Jefferson Lines*, 514 U.S. at 197).

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.*

168. *See id.*

C. Comparison to Wynne

Finally, the *Zilka II* court compared and contrasted the facts at issue with those of *Wynne*.[169] The court emphasized that both the state and county taxes in *Wynne* were collected by the same governing authority and that Maryland's county tax did not permit an offsetting credit for similar taxes paid to other jurisdictions.[170] The *Zilka II* court then underscored that the *Wynne* Court had explicitly stated that Maryland could have cured its discriminatory tax scheme by offering a credit against its county tax.[171]

The *Zilka II* court asserted that both Philadelphia's income tax, which provided a credit for taxes paid to Wilmington, and Pennsylvania's income tax, which provided a credit for taxes paid to Delaware, were in accordance with the remedy the Supreme Court had recommended in *Wynne*.[172] Judge Wojcik dismissed Zilka's assertion that the Court's holding in *Wynne* required Philadelphia to allow an additional credit for the unused excess credit from her Delaware tax that could not be fully credited against her Pennsylvania tax.

Judge Wojcik distinguished *Zilka II* from *Wynne* by asserting that, as a state tax, the Delaware tax was "dissimilar" to the Philadelphia tax, a city tax.[173] By contrast, in *Wynne*, Maryland's "'county' tax was actually a state tax because it was administered, adopted, mandated, and collected by the state."[174] The court determined that Philadelphia and Pennsylvania must apply an "apples to apples approach," only offsetting state taxes with other state taxes and local taxes with other local taxes.[175]

The court also held that, although this taxpayer paid more in taxes than her intrastate counterparts, "such is not the result of an unconstitutional tax scheme" and was instead the "result of the interaction of two different but nondiscriminatory and internally consistent schemes."[176] The court once again characterized Zilka's situation of living in one state but working in another state as her "cho[ice]."[177]

D. Conclusion of Zilka II

The *Zilka II* court concluded that the taxpayer was not subject to double taxation on her interstate income, as it found no support for the taxpayer's argument that "local and state taxes must be aggregated for Commerce Clause purposes."[178] Importantly, the court paid no regard to *Wynne*'s holding that courts must evaluate a state's tax scheme *as a whole* without necessarily giving credence to the state's own labeling of such

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169. *Id.* at *5 (citing Comptroller of the Treasury v. Wynne, 575 U.S. 542, 545–47 (2015)).

170. *Id.* (citing *Wynne*, 575 U.S. at 546, 564–65).

171. *Id.* at *6 (citing *Wynne*, 575 U.S. at 568).

172. *Id.* (citing *Wynne*, 575 U.S. at 568).

173. *Id.*

174. *Id.*

175. *Id.* (internal quotation mark omitted) (quoting *Zilka I*, Nos. 02438, 02439, 1063 CD 2019, 1064 CD 2019, 2019 WL 4396294 (Pa. Ct. C.P. Aug. 28, 2019)).

176. *Id.* (quoting *Wynne*, 575 U.S. at 562).

177. *Id.*

178. *Id.*

taxes.[179] The *Zilka II* court held that Philadelphia's tax scheme did not violate the dormant Commerce Clause, affirming the trial court's disposition.[180]

V. PERSONAL ANALYSIS

The Commonwealth Court of Pennsylvania's decision in *Zilka II* missed the mark when addressing the Commerce Clause issues in the challenged state and local tax scheme.[181] The court misapplied the relevant Supreme Court precedent, failing to evaluate the state's tax system as a whole.[182] Additionally, the challenged tax regime includes several defects from a tax policy standpoint, making its perpetuation unsustainable, especially in light of the rise in remote work.[183]

This Section proceeds in four Parts. Part V.A criticizes the court's failure to accurately assess the constitutional problems present in the challenged tax scheme. Part V.B then asserts that although the *Zilka* tax system was deemed constitutional, it has fundamental tax policy flaws and cannot stand. Part V.C explores the Supreme Court's passiveness in helping taxpayers and the states clear up the prevailing uncertainty in interstate taxation. Finally, Part V.D focuses on the possible solutions available to address these state and local taxation issues.

A. *The* Zilka II *Court Did Not Correctly Address the Relevant Constitutional Issues*

In *Zilka II*, the Commonwealth Court of Pennsylvania failed to accurately apply dormant Commerce Clause principles, disregarding the fact that states grant authority to their political subdivisions.[184] The court also ignored the Supreme Court's decision in *Wynne*, by failing to evaluate Pennsylvania's tax scheme as a whole.[185]

1. Political Subdivisions Derive Their Power To Tax from the States

The *Zilka II* court improperly characterized the City of Philadelphia as an independent taxing authority.[186] The political subdivisions of a state (i.e., cities, counties, and municipalities) are "creatures of the state."[187] A locality's authority to act, specifically to tax, is derived from the state's explicit grant of such authority.[188]

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179. *See id.*; *Wynne*, 575 U.S. at 564 n.8.

180. *Zilka II*, 2022 WL 67789, at *6–7.

181. *See id.* at *5–6.

182. *See Wynne*, 575 U.S. at 564 n.8.

183. See *infra* Part V.B for a discussion of the system's tax policy flaws, namely lack of proportionality, promotion of uncertainty, and causing deadweight loss.

184. *See Zilka II*, 2022 WL 67789, at *5–6; *see also* HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 25.

185. *See Zilka II*, 2022 WL 67789, at *5–6; *see also Wynne*, 575 U.S. at 564 n.8.

186. *See Zilka II*, 2022 WL 67789, at *5–6 ("Philadelphia and Pennsylvania are two distinct taxing jurisdictions administering two distinct taxes to two different sets of citizenry.").

187. HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 16 (citing Hunter v. City of Pittsburgh, 207 U.S. 161, 178–79 (1907)); *see also* McMillian v. Monroe Cnty., 520 U.S. 781, 790 (1997); Ysursa v. Pocatello Educ. Ass'n, 555 U.S. 353, 362 (2009).

188. *See, e.g.*, Mastrangelo v. Buckley, 250 A.2d 447, 452–53 (Pa. 1969) ("Absent a grant or a delegation of the power to tax from the General Assembly, no municipality, including Philadelphia, a city of

Specifically, the General Assembly of the Commonwealth of Pennsylvania granted the City of Philadelphia its broad self-governing authority, including the power to tax, by way of the First Class City Home Rule Act.[189] Absent this assignment of power, Philadelphia would not possess any taxing privilege.[190] In light of this dynamic between states and their political subdivisions, "the fact that the state tax power is exercised by a political subdivision of the state rather than by the state itself is of no constitutional moment."[191]

Based on these considerations, the *Zilka II* court's effort to distinguish the facts of *Wynne*—dealing with a state tax disguised as a county tax—from Philadelphia's city tax was immaterial.[192] Since the levying of local taxes was authorized by the Commonwealth of Pennsylvania, it must fundamentally be considered a state tax for Commerce Clause purposes.[193] As the Supreme Court dictated in *Wynne*,[194] when the *Zilka II* court examined the interaction of the Pennsylvania-Philadelphia tax scheme with the combined Delaware-Wilmington tax regime, it should have analyzed the entire Pennsylvania tax scheme as one whole, encompassing both the state-level tax and Philadelphia's city-level tax.[195]

Had the *Zilka II* court used this aggregate analysis approach, collapsing city taxes into the broader tax scheme of the state, it likely would have concluded differently.[196] Philadelphia's refusal to allow a credit against its city tax for the excess Delaware tax paid was not simply the application of an "apples to apples approach," maintaining city taxes and state taxes in their own separate lanes, but was rather a dormant Commerce Clause violation.[197] The taxpayer who engaged in out-of-state economic activity was subject to a higher tax rate than those only earned income within the state.[198]

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the first class, has any power or authority to levy, assess or collect taxes." (emphasis omitted)); HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 16 ("Because political subdivisions of a state are creatures of the state, their exercises of tax power are treated as the exercise of state tax power and adjudicated according to the standards restraining the exercise of state tax power." (footnote omitted)); *Ysursa*, 555 U.S. at 362 ("'Political subdivisions of States—counties, cities, or whatever—never were and never have been considered as sovereign entities.' They are instead 'subordinate governmental instrumentalities created by the State to assist in the carrying out of state governmental functions.'" (citation omitted) (quoting Reynolds v. Sims, 377 U.S. 533, 575 (1964))).

189. 53 PA. STAT. AND CONS. STAT. ANN. §§ 13101–13157 (West 2024); *see also id.* § 15971; PHILADELPHIA HOME RULE CHARTER § 1-100 (1951).

190. § 13133(a)(8) ("[N]o city shall exercise powers contrary to, or in limitation or enlargement of, powers granted by acts of the General Assembly . . . [including] [l]imiting rates and fixing subjects of taxation . . . .").

191. HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 16.

192. See *infra* Part V.A.2 for further discussion regarding the immateriality of the differences between *Wynne*'s county tax and *Zilka*'s city tax.

193. *See* Comptroller of the Treasury v. Wynne, 575 U.S. 542, 564 n.8 (2015).

194. *See id.*

195. *See* HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 33.

196. *See Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *5–6 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision); HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 33.

197. *See Zilka II*, 2022 WL 67789, at *5–6; HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 33.

198. *See Zilka II*, 2022 WL 67789, at *5–6; HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 33.

2. The *Zilka II* Court Failed To Follow the Dormant Commerce Clause Principles Set Forth in *Wynne*

When examining state taxation schemes through the lens of the dormant Commerce Clause in *Zilka II*, the Commonwealth Court of Pennsylvania disregarded key principles that the Supreme Court articulated in *Wynne*.[199] The Court in *Wynne* declared that when applying the internal consistency test, a court must evaluate a state's tax scheme "*as a whole*," aggregating all levels of tax across the relevant political subdivisions within the state.[200] The Court likely reasoned that because localities are creatures of the state and derive their power to tax solely by grant of such authority by the state, the taxes of such localities must be compiled at the state level.[201]

The *Wynne* Court also underscored that for dormant Commerce Clause purposes, a state's own labeling of different taxes (i.e., county tax, city tax, state tax) is immaterial to the analysis.[202] If the labels assigned by the state were dispositive, then the state could essentially tax any source of income at discriminatory rates simply by renaming the tax.[203] The *Wynne* Court's approach to dormant Commerce Clause analyses requires that all the taxes within the state and authorized by the state "must be considered as one."[204]

The City of Philadelphia and the Commonwealth Court noted apparent differences between the county tax in *Wynne* and the Philadelphia wage tax at issue in *Zilka II*.[205] Maryland's county tax was deemed a state tax, in *Wynne*, because it was collected by the State of Maryland's Comptroller,[206] whereas Philadelphia's tax is collected by the City of Philadelphia, not the Commonwealth of Pennsylvania.[207] Additionally, Maryland's county tax was enacted by Maryland's state legislature,[208] in contrast to Philadelphia's tax, which was enacted by a Philadelphia City Council ordinance.[209]

However, these differences are immaterial and wholly insufficient to prevent the application of *Wynne*'s legal reasoning to *Zilka*.[210] Though Maryland's county tax was collected by the State Comptroller, in *Wynne*, the Comptroller of Maryland

199. *See Zilka II*, 2022 WL 67789, at *5–6; *Wynne*, 575 U.S. at 564 n.8.

200. *Wynne*, 575 U.S. at 564 n.8 (emphasis added) ("In order to apply the internal consistency test in this case, we must evaluate the Maryland income tax scheme as a whole.").

201. See *supra* Part V.A.1 for a discussion of the origin of political subdivisions' self-governing authority.

202. *Wynne*, 575 U.S. at 564 n.8.

203. *Id.*

204. *Id.*

205. Brief of Appellee the City of Philadelphia Department of Revenue at 19–21, *Zilka III*, Nos. 31 EAL 2022, 32 EAL 2022, 2022 WL 2439600 (Pa. July 5, 2022) [hereinafter Brief for Appellee]; *Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *5–6 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision).

206. Brief for Appellee, *supra* note 205, at 21; *Wynne*, 575 U.S. at 546.

207. Brief for Appellee, *supra* note 205, at 21.

208. *See id.* at 20.

209. *See id.* at 13.

210. *See* Reply Brief of Appellant Diane Zilka at 11–12, *Zilka III*, Nos. 31 EAL 2022, 32 EAL 2022, 2022 WL 2439600 (Pa. July 5, 2022) [hereinafter Reply Brief for Appellant].

maintained[211] that the county tax was a *local* income tax which the state collected "*as a convenience for local governments*."[212] The accommodative nature of Maryland's county tax was central to the Court's conclusion that the labels assigned to taxes by a state and its political subdivisions are not determinative.[213]

Further, the fact that Maryland's tax was enacted by the state legislature while Philadelphia's was enacted by city ordinance cannot be dispositive.[214] Such a distinction is merely one of form, not substance.[215] If a tax's form were conclusive, then states could "circumvent the U.S. Constitution by merely changing how a tax is enacted, regardless of the fact that the taxes are imposed upon the same income, within the same state."[216] The differences between the taxes in *Wynne* and *Zilka II* are insignificant and should not be considered in the case's Commerce Clause analysis.[217]

The Commonwealth Court failed to examine Pennsylvania's tax scheme as a whole and failed to set aside the labels Pennsylvania had assigned to the taxes at issue.[218] The Commonwealth Court should have combined the Philadelphia city tax with the Pennsylvania state tax, in order to analyze the effect of the tax regime as required by the internal consistency test.[219] By doing so, the *Zilka II* court would have concluded that the overall Pennsylvania tax scheme inherently discriminates against interstate commerce, since identical application by every state would necessarily place interstate commerce at a disadvantage to intrastate commerce.[220]

Appellant's brief to the Supreme Court of Pennsylvania illustrates the lack of fair apportionment in the challenged tax scheme, thus undermining the Commonwealth Court's assertion that because all residents pay the same 3.92% tax rate, Philadelphia does not tax interstate income more heavily than intrastate income.[221] In 2014, one of the years at issue in *Zilka II*, a taxpayer working exclusively in Philadelphia would have incurred a 6.99% total tax rate.[222] By contrast, the taxpayer in *Zilka* was subject to

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211. *Maryland Income Tax Rates and Brackets*, COMPTROLLER OF MD., https://www.marylandtaxes.gov/individual/income/tax-info/tax-rates.php [https://perma.cc/K5ER-B9VK] (last visited May 3, 2024) ("Maryland's 23 counties and Baltimore City levy a local income tax which we collect on the state income tax return as a convenience for local governments.").

212. Reply Brief for Appellant, *supra* note 210, at 12.

213. *See* Comptroller of the Treasury v. Wynne, 575 U.S. 542, 564 n.8 (2015).

214. Reply Brief for Appellant, *supra* note 210, at 11.

215. *See id.*

216. *Id.*

217. *See id.* at 8–12.

218. *See Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *5–6 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision).

219. *See* Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995); Comptroller of the Treasury v. Wynne, 575 U.S. 542, 562 (2015).

220. *See Zilka II*, 2022 WL 67789, at *5–6; HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 33 ("[I]f one views the Pennsylvania tax regime 'as a whole' at the state level taxpayers engaged in cross-border economic activity would often pay higher taxes than taxpayers that confined their activity to a single state in violation of the Commerce Clause.").

221. Brief of Appellant Diane Zilka at 29 fig.2, *Zilka III*, Nos. 31 EAL 2022, 32 EAL 2022, 2022 WL 2439600 (Pa. July 5, 2022) [hereinafter Brief for Appellant]; *Zilka II*, 2022 WL 67789, at *3.

222. Brief for Appellant, *supra* note 221, at 29 fig.2.

a total tax rate of 8.92%, since she was left with a 1.93% unused excess credit for taxes paid to Delaware but not allowed as a credit against her Philadelphia taxes.[223] Had the court correctly mandated that Philadelphia permit a credit for the remaining unused credit of incremental Delaware tax that exceeded her Pennsylvania tax, the taxpayer would have been taxed at 6.99%, like her counterparts working entirely in-state, thereby eliminating the discriminatory treatment of interstate commerce.[224]

As a whole, the challenged tax scheme in *Zilka* violates the dormant Commerce Clause.[225] The City of Philadelphia is a creature of the Commonwealth of Pennsylvania,[226] and its tax regime cannot withstand constitutional scrutiny in the face of the *Wynne* Supreme Court precedent requiring an examination of Pennsylvania's tax scheme as a whole and without regard for the state's assigned tax labels.[227]

B. The Challenged Tax Scheme in Zilka *Conflicts with Several Tenets of Sound Tax Policy*

Even if the challenged Pennsylvania-Philadelphia tax scheme were deemed constitutional, the scheme is still fundamentally flawed, as it violates several core principles of good tax policy.[228] In *The Wealth of Nations*, economist Adam Smith set forth four maxims of taxation: (1) proportionality, (2) certainty, (3) convenience of payment, and (4) minimization of deadweight loss.[229] For years, governments and economists have used these principles to guide tax policy decisions.[230] However, the tax scheme in *Zilka* fails at least three of these tenets and, therefore, is unsound from a tax policy perspective.[231]

1. The Lack of Proportionality in the *Zilka* Tax Scheme Promotes Inequity

Smith's first maxim of taxation is proportionality—the amount of tax owed by taxpayers should be proportionate to their relative ability to pay such taxes.[232] To achieve this aspirational level of fairness and ensure that similarly situated taxpayers

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223. *Id.*

224. *Id.*

225. *See Zilka II*, 2022 WL 67789, at *5–6; *see also* HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 33.

226. *See* HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 21.

227. *See* HELLERSTEIN & HELLERSTEIN, *supra* note 7, at 33; Comptroller of the Treasury v. Wynne, 575 U.S. 542, 564 n.8 (2015).

228. *See Zilka II*, 2022 WL 67789, at *5–6; *see also* Paul Mueller, *Adam Smith on Public Policy: Four Maxims of Taxation*, CATO INST. (Jan. 4, 2016), https://www.libertarianism.org/columns/adam-smith-public-policy-four-maxims-taxation [https://perma.cc/74LY-KU2U]; ASS'N OF INT'L CERTIFIED PRO. ACCTS., GUIDING PRINCIPLES OF GOOD TAX POLICY: A FRAMEWORK FOR EVALUATING TAX PROPOSALS, 3 (2017) [hereinafter AICPA, GOOD TAX POLICY], https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf [https://perma.cc/58HZ-LT7X].

229. Mueller, *supra* note 228.

230. AICPA, GOOD TAX POLICY, *supra* note 228, at 3.

231. *See Zilka II*, 2022 WL 67789, at *6.

232. Mueller, *supra* note 228 ("The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.").

are taxed similarly, a tax system must achieve two types of equity: horizontal equity and vertical equity.[233] Under horizontal equity, two taxpayers with an equivalent ability to pay ought to pay the same amount in taxes.[234] By contrast, for vertical equity, when two taxpayers have a different ability to pay, the one with the greater ability to pay should pay more.[235]

The principle of proportionality breaks down in the challenged tax scheme in *Zilka*.[236] There, a taxpayer who lives in Philadelphia and works in Wilmington incurs a tax rate of 8.92%.[237] Meanwhile, her Philadelphia counterparts who work entirely within city limits, who have the exact same level of income and utilize the same city resources and benefits, are subject to a 6.99% tax rate.[238] Such a tax regime destroys horizontal equity, since the taxpayer working outside the state pays disproportionately more in taxes than those who work inside the state, though both sets of taxpayers have an equal ability to pay.[239] Had the City of Philadelphia permitted a credit for the remaining unused credit of incremental Delaware tax that exceeded the taxpayer's Pennsylvania tax, her tax rate would have decreased to 6.99%, matching the tax rate of her counterparts working inside the state and restoring horizontal equity.[240]

2. The Tax Scheme in *Zilka* Provides Little Certainty in Tax Administration

Smith's next maxim for effective tax policy is certainty—a tax system should have clarity in the amount, timing, and method of tax payments.[241] Taxpayers should not only have reasonable certainty with regard to calculating the exact taxes they owe, but also certainty as who is owed these amounts.[242] Certainty is vital to a robust tax system, as it enhances taxpayer compliance and instills confidence in and respect for the system.[243] Such certainty is generally attained through clear statutes, regulations, and administrative guidelines, supplemented by coherent and consistent case law interpreting them.[244]

The challenged tax scheme in *Zilka* lacks certainty, and it is ambiguous regarding the political subdivision that is owed and in what amount.[245] The *Zilka II* court's disregard of one of the key Supreme Court assertions in *Wynne*, that a state's tax

233. AICPA, GOOD TAX POLICY, *supra* note 228, at 7.

234. *Id.*

235. *Id.*

236. *Zilka II*, 2022 WL 67789, at *6.

237. *See id.* at *1; Brief for Appellant, *supra* note 221, at 28 fig.1.

238. *Zilka II*, 2022 WL 67789, at *1; Brief for Appellant, *supra* note 221, at 28 fig.1.

239. *See* AICPA, GOOD TAX POLICY, *supra* note 228, at 7.

240. *See* Brief for Appellant, *supra* note 221, at 29 fig.2.

241. Mueller, *supra* note 228 ("[The] tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person."); AICPA, GOOD TAX POLICY, *supra* note 228, at 7.

242. *See* AICPA, GOOD TAX POLICY, *supra* note 228, at 7.

243. *Id.*

244. *Id.*

245. *Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *5–6 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision).

system must be analyzed as a whole, is a clear example of the inconsistent application of dormant Commerce Clause principles in interstate taxation regimes.[246] The taxpayer in *Zilka*, as well as those in similar out-of-state employment situations, had anything but certainty as to the amount of income tax she owed to each state and city, since in certain instances courts have paid no regard to a state's own labels of its taxes while in others such labels were determinative.[247]

This inconsistency has been exacerbated by the Supreme Court's failure to weigh in on cross-state tax issues, especially in light of the rise of remote work opportunities following the onset of the COVID-19 pandemic.[248] Until more clarity is provided, whether by the Supreme Court or Congress, many taxpayers across the country will continue to stumble through this uncertainty, as more and more people are working remotely for out-of-state employers and are facing interstate tax issues similar to those encountered by the taxpayer in *Zilka*.[249]

3. The *Zilka* Tax Scheme Disrupts Economic Efficiency by Causing Deadweight Loss

Smith's final maxim is limiting deadweight loss, which involves minimizing costs to taxpayers and the government that exceed those stemming from the direct payment and collection of taxes.[250] These deadweight losses may include the administrative costs of hiring tax collectors, the disincentives taxes create for production and industry, the incentives taxes have on tax evasion and black market activity, and the costs of hiring tax accountants and attorneys to assist with compliance.[251] As tax system complexity increases, government administration and taxpayer compliance generate greater deadweight losses, and this occurs to the detriment of economic efficiency.[252]

The tax regime in *Zilka* does not minimize deadweight loss, but rather, it causes taxpayers and the government to bear more costs.[253] As a result of the uncertainty and complexity surrounding the system, taxpayers must incur the costs of employing tax

246. *See id.* at *6; Comptroller of the Treasury v. Wynne, 575 U.S. 542, 564 n.8 (2015).

247. *See Zilka II*, 2022 WL 67789, at *5–6.

248. See *infra* Part V.C for a discussion of the Supreme Court's recent inaction in the field of interstate taxation, most notably in *New Hampshire v. Massachusetts*, despite many states submitting briefs requesting that the Court take up the issue. *See* Richard C. Auxier, *Supreme Court Punts on State Tax Question About Remote Work*, TAX POL'Y CTR.: TAX VOX (June 28, 2021), https://www.taxpolicycenter.org/taxvox/supreme-court-punts-state-tax-question-about-remote-work [https://perma.cc/6VWV-QUTJ]; New Hampshire v. Massachusetts, 141 S. Ct. 2848 (2021) (denying motion for leave to file a bill of complaint).

249. *See Pennsylvania Rules on Philly Wage Tax Credit Case*, GRANT THORNTON (Mar. 10, 2022), https://www.grantthornton.com/insights/alerts/tax/2022/salt/p-t/pa-rules-on-philly-wage-tax-credit-case-03-10 [https://perma.cc/A8HS-7UWC].

250. Mueller, *supra* note 228 ("Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the publick treasury of the state." (quoting 5 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS pt. II, ¶ 4 (1776))).

251. *Id.*

252. *See* AICPA, GOOD TAX POLICY, *supra* note 228, at 8.

253. *See Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *5–6 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision).

accountants and lawyers to ensure conformity with the tax rules of multiple jurisdictions.[254] This lack of definiteness also creates significant litigation costs for both taxpayers and the government, when challenges—like the one in *Zilka II*—naturally arise.[255]

Moreover, with the prospect of workers having to pay higher taxes on the same amount of income as their neighbors solely because they work remotely or have to commute a bit further to their office, workers may be discouraged from accepting jobs in cities outside of their state.[256] This is especially problematic in the new age of remote work positions and work-from-home accommodations, as additional taxes on out-of-state income could disrupt the flow of employment market activity and, thus, may diminish economic productivity.[257]

4. Upon Close Inspection, the Policy Arguments Supporting the City of Philadelphia's Position Are Unpersuasive

In *Zilka*, the City of Philadelphia raised an interesting question when it asked why the City should be the party responsible for absorbing the sought credit.[258] The City's perspective was that it should not be essentially "subsidiz[ing] Delaware's decision to impose a higher tax rate on Taxpayer than the Commonwealth of Pennsylvania."[259] There is certainly an issue of harmonization between the taxes levied by the State of Delaware and the Commonwealth of Pennsylvania.[260] Philadelphia's position was that the 1.93% unused credit was generated at the state level, so the City ought not to bear the burden—one it likely could not afford[261]—of accommodating a credit that resulted from the political choices made by the two states.[262]

However, following an inspection of the actual numbers, the prospect of providing the credit is not as drastic as it may initially seem.[263] Though Philadelphia contests having to take the hit for a lack of harmonization at the state level,[264] the reality is that the City is the most logical taxing jurisdiction to accommodate the credit and restore horizontal equity.[265] It makes little sense for the Commonwealth of Pennsylvania to provide the additional credit, since its 3.07% tax rate is completely wiped out by the credit it provides for taxes paid to Delaware; any incremental credit

254. *See* AICPA, GOOD TAX POLICY, *supra* note 228, at 8.

255. *See id.*; *see also Zilka II*, 2022 WL 67789, at *5–6.

256. *See Pennsylvania Rules on Philly Wage Tax Credit Case*, *supra* note 249.

257. *See id.*

258. *See* Brief for Appellee, *supra* note 205, at 17.

259. *Id.*

260. *See id.*

261. *See* Michael Butler, *Reminder: Philly Is Still the Poorest Big City in America*, TECHNICALLY MEDIA INC. (Oct. 14, 2020, 11:29 AM), https://technical.ly/civic-news/poorest-big-city-america-workforce-development/ [https://perma.cc/7J84-UNPS].

262. *See* Brief for Appellee, *supra* note 205, 205 at 17.

263. *See* Brief for Appellant, *supra* note 221, at 29 fig.2.

264. Brief for Appellee, *supra* note 205, at 17.

265. *See* Brief for Appellant, *supra* note 221, at 29 fig.2.

offered by Pennsylvania would put the Commonwealth at a negative effective tax rate with respect to taxpayers earning out-of-state income—an illogical result.[266]

By contrast, after providing a credit for taxes paid to Wilmington, the City of Philadelphia still imposes a remaining 2.67% rate of tax on the *Zilka* taxpayer.[267] As a result, even if the entire unused 1.93% credit were applied to the Philadelphia tax, the City would still be generating tax revenue from the *Zilka* taxpayer, for income earned outside the jurisdiction—realizing a net tax rate of 0.74%.[268] This scenario would equalize the effective tax rate incurred by the *Zilka* taxpayer with the rate on those working entirely intrastate, while still putting the City of Philadelphia in the black.[269]

Of course, for this tax scheme to be fair across taxing jurisdictions, in the inverse scenario—where a taxpayer resides in Wilmington but works in Philadelphia—the State of Delaware would have to be on the hook for the excess of Philadelphia's tax rate over that of Wilmington.[270] In that case, the taxpayer would be left with a 2.67% unused credit at the local level, after Wilmington credits the tax paid to Philadelphia of 3.92%, up to the Wilmington tax rate of 1.25%.[271] Delaware (tax rate of 5%) would provide a 3.07% credit for taxes paid to Pennsylvania, leaving a remaining 1.93% tax that would otherwise be due to the State of Delaware.[272]

By collapsing all local taxes with those at the state level, as asserted by *Wynne*,[273] Delaware would then be required to provide the taxpayer with an incremental credit reflecting the unused credit at the city level, but only up to Delaware's remaining tax rate of 1.93%.[274] This example would result in the taxpayer paying no income tax to either Delaware or Wilmington, though still with an unused credit of 0.742%.[275] Though this hypothetical Wilmington-residing taxpayer would owe 0.742% more in taxes than her neighbors who work exclusively within Wilmington, such would merely be the "result of the interaction of two different but nondiscriminatory and internally consistent schemes."[276] Thus, it would survive dormant Commerce Clause scrutiny.[277] This taxing dynamic would need to hold true in any interstate employment arrangement,[278] regardless of the size of the locality in which the taxpayer resides or works.[279]

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266. *See id.*

267. *See id.*

268. *See id.*

269. *See id.*

270. *See id.*

271. *See id.*

272. *See id.*

273. Comptroller of the Treasury v. Wynne, 575 U.S. 542, 564 n.8 (2015).

274. *See* Brief for Appellant, *supra* note 221, at 29 fig.2.

275. *See id.*

276. *See id.*

277. *See Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *6 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision) (quoting *Wynne*, 575 U.S. at 562).

278. In its amicus brief, the Pennsylvania Department of Revenue posited a situation in which a taxpayer lives in Sayre Borough, Pennsylvania but works in Binghamton, New York. Amicus Brief for Pa. Dep't of Revenue at 19, *Zilka III*, Nos. 31 EAL 2022, 32 EAL 2022, 2022 WL 2439600 (Pa. July 5, 2022), 281

C. The Supreme Court Has Neglected To Opine on the Issue of Interstate Taxation, by Declining To Hear New Hampshire v. Massachusetts

In 2020, the State of New Hampshire filed a lawsuit against the Commonwealth of Massachusetts in the United States Supreme Court.[280] The complaint challenged Massachusetts's decision to continue collecting income taxes from residents of New Hampshire who worked for Massachusetts companies but were working from home in New Hampshire, due to the COVID-19 pandemic shutdown.[281]

Many people hoped that the Supreme Court would hear the case of *New Hampshire v. Massachusetts*, wanting the Court to halt the practice, by some states, of collecting taxes from remote workers who were employed by in-state companies but who performed the work outside of the state.[282] Fourteen states submitted briefs supporting New Hampshire's position, whereas no briefs were submitted on behalf of Massachusetts, which suggests that other states are grappling with similar issues.[283]

A.3d 1029 (unpublished table decision). Since Binghamton does not impose a local tax, under current law the taxpayer's local borough and school district would net a combined 1.5% rate of tax. *Id.* at 19–20. But, under an aggregated system, if Sayre Borough must provide a credit for unused state level credits, the locality would no longer receive any tax revenue from this taxpayer, since New York's state tax rate exceeds that of Pennsylvania by more than the total amount of the locality's rate of tax. *Id.* at 20. This result may seem extreme when impacting a significantly smaller political subdivision, especially should Sayre Borough be confronted with a multitude of residents who work out of state in localities with lower—or no—rates of tax. *See id.* at 19–20. However, if Sayre Borough feels as though it is not collecting enough tax revenue, its legislature can raise the locality's tax rate. *See id.* Though, in that case, Sayre residents who work within the borough would essentially be subsidizing those who work outside their home state. *See id.*

279. This result—a small political subdivision not receiving tax revenue from its residents due to credits provided for taxes paid to other jurisdictions—is relatively commonplace. *See Taxpayer Annual Local Earned Income Tax Return (F-1) FAQ*, BERKHEIMER TAX INNOVATIONS, https://www.hab-inc.com/local-earned-income-tax-return-faq/ [https://perma.cc/A9P7-H4X6] (last visited May 3, 2024) ("If employed in Philadelphia [and residing in Allentown], you may use the Philadelphia Wage Tax as a credit against your liability to your resident jurisdiction, but the credit may not exceed your resident jurisdiction tax rate."). For instance, a taxpayer residing in Allentown, Pennsylvania owes the City and school district a combined 1.975% in income taxes. *Municipal Statistics*, PA. DEP'T OF CMTY. & ECON. DEV., https://munstats.pa.gov/Reports/ReportInformation2.aspx?report=EitWithCollector_Dyn_Excel&type=O [https://perma.cc/YRY4-8HMQ] (last visited May 3, 2024) (The 1.975% can be obtained from the Total Resident Income Tax column). However, instead of commuting to work out of state, consider the consequences of that taxpayer working in Philadelphia. *See* Brief for Appellant, *supra* note 221, at 29 fig.2. In this circumstance, the taxpayer must pay Philadelphia's tax of 3.92%, and then Allentown credits her Philadelphia taxes, up to Allentown's charged rate of 1.975%. *See* BERKHEIMER TAX INNOVATIONS, *supra* note 279. The taxpayer's locality of residence would earn no tax revenue from this taxpayer based on its credit provided for income earned in the state but out of the taxing jurisdiction. *See id.* Since this tax scheme does not invoke interstate commerce, the dormant Commerce Clause would not be triggered, so the Commonwealth of Pennsylvania would not be on the hook for providing this taxpayer with her remaining unused credit derived at the local level. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

280. Press Release, New Hampshire Governor Chris Sununu, State of New Hampshire v. Commonwealth of Massachusetts (Oct. 19, 2020), https://www.governor.nh.gov/news-and-media/state-new-hampshire-v-commonwealth-massachusetts [https://perma.cc/7DFH-RXZ8].

281. Auxier, *supra* note 248; Press Release, *supra* note 278 (referring to Massachusetts's tax as an "unconstitutional tax grab").

282. 141 S. Ct. 2848, 2848 (2021); Auxier, *supra* note 248.

283. *Id.*

However, others, including the Biden administration, contended that the Supreme Court should not hear this case because the "pandemic-specific circumstances," which they presumed to be temporary, made the case "a poor vehicle in which to address the broader issues of interstate taxation."[284]

Ultimately, the Supreme Court did not grant a review of *New Hampshire v. Massachusetts*.[285] Though the Court did not explicitly articulate a reason for its denial, the Court and the Biden administration mischaracterized the brevity of the remote work situation.[286] Though several companies have been instituting return-to-work policies,[287] according to a 2023 WFH Research report, 12.7% of full-time employees continue to work from home and 28.2% work in a hybrid model.[288] This dynamic cuts against the *Zilka II* court's assertion that taxpayers necessarily have the *choice* to work in a different jurisdiction than that in which they reside—in many circumstances, the companies, not the employees, are the ones dictating where work is performed.[289] With states and companies struggling to navigate the uncertainty of interstate taxation, the onus is on the Supreme Court to take action and provide guidance.[290]

D. Does a Practical Solution for the Duplicative Interstate Taxation Issue Even Exist?

With each state imposing different standards for determining taxpayer income apportionment, which causes uncertainty and cripples interstate commerce, the natural question that arises is whether a pragmatic solution exists.[291] The obvious resolution is to mandate uniformity between state and local tax jurisdictions.[292] Otherwise, "[the]

284. *Id.* (quoting Brief for the United States as Amicus Curiae at 21, 22, *Zilka III*, Nos. 31 EAL 2022, 32 EAL 2022, 2022 WL 2439600 (Pa. July 5, 2022)).

285. 141 S. Ct. at 2848; Auxier, *supra* note 248.

286. *See* Auxier, *supra* note 248; Eric House, *Supreme Court Considering Taking Up Remote Work Taxation Case*, WORLDWIDE ERC (Apr. 27, 2023), https://www.worldwideerc.org/news/public-policy/supreme-court-considering-taking-up-remote-work-taxation-case [https://perma.cc/U5TA-C3BD].

287. Lorie Konish, *Amid a Return-to-Office Push, It's Still Possible for Workers To Get Flexible Schedules. 'Think About It like a Salary Negotiation,' Expert Says*, CNBC (Aug. 25, 2023, 3:20 PM), https://www.cnbc.com/2023/08/25/how-to-get-a-flexible-work-schedule-amid-a-return-to-office-push.html [https://perma.cc/49VW-869J] (mentioning that Meta and Goldman Sachs are pushing mandatory return-to-office policies).

288. Kathy Haan, *Remote Work Statistics and Trends in 2023*, FORBES (June 12, 2023, 5:29 AM), https://www.forbes.com/advisor/business/remote-work-statistics [https://perma.cc/DG6R-3CSJ]; *see also* Brody Ford & Bloomberg, *Return to the Office? No Way, Say Some Tech Companies that Are Letting Workers Stay Remote Despite Rival Firms Imposing Mandates*, FORTUNE (Aug. 16, 2023, 2:09 PM), https://fortune.com/2023/08/16/atlassian-airbnb-remote-work-return-to-office/ [https://perma.cc/7TZD-PUGD] (discussing certain corporate backers of remote work, including Atlassian, Airbnb, and Dropbox).

289. *Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *6 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision) ("Taxpayer chose to work in a jurisdiction with a higher tax rate. Philadelphia is not responsible for the fact that Delaware charges 1.93% more than Pennsylvania.").

290. *See* Auxier, *supra* note 248.

291. *See* Moore, *When Will Congress Intervene?*, *supra* note 2, at 179–80; Brian L. Hazen, *Rethinking the Dormant Commerce Clause: The Supreme Court as Catalyst for Spurring Legislative Gridlock in State Income Tax Reform*, 2013 BYU L. REV. 1021, 1022–24.

292. Moore, *When Will Congress Intervene?*, *supra* note 2, at 179–80.

multitude of tax systems amounts to a drag on interstate trade almost as debilitating as the border restrictions our federal system was originally designed to prevent."[293]

Uniformity in state and local taxation would conform to the bounds of the dormant Commerce Clause.[294] With a tax scheme encompassing identical standards across taxing jurisdictions, the internal consistency test would become a nonissue, because the test for internal consistency is whether identical application of the challenged tax scheme across all taxing jurisdictions would infringe on interstate commerce.[295] Additionally, the issue in *Zilka* would never again occur, since each political subdivision would have a uniform rule for determining the out-of-state taxes that could be credited against a taxpayer's in-state tax bill, thereby eliminating the risk of multiple taxation.[296]

A uniform set of taxing rules would also follow the tenets of sound tax policy.[297] Proportionality and horizontal equity would be restored, since each taxpayer of the same ability to pay would owe the same amount of tax.[298] Moreover, individuals and states would have enhanced certainty under a uniform regime with regard to which jurisdiction is entitled to tax and in what amount.[299] Furthermore, deadweight loss would be diminished, because government administration and taxpayer compliance costs—including attorney fees, litigation costs, and collection costs—would be substantially reduced by the clarity and simplicity of a uniform tax system.[300]

Though uniformity in state and local taxation would be optimal, it may also be unattainable.[301] Congress is an unlikely candidate to enact legislation requiring uniformity, absent an agreement among states about how to structure such a system.[302] But, a multistate agreement and congressional action are improbable in light of the current congressional stalemate and the fact that "states and taxpayers usually take positions in hearings on state and local tax legislation that are driven in large part by narrow self-interest and rarely reflect the greater good."[303]

As a result of the congressional stalemate, the responsibility for instituting uniformity must rest with the Supreme Court.[304] However, the Court has repeatedly

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293. *Id.* at 179 (alteration in original) (quoting Gordon D. Henderson, *What We Can Do About What's Wrong with the Tax Law*, 49 TAX NOTES 1349, 1352 (1990)).

294. *See id.* at 179–81.

295. *See* Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995).

296. *See Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *5–6 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision); Moore, *When Will Congress Intervene?*, *supra* note 2, at 179–81.

297. *See* Mueller, *supra* note 228.

298. *See id.*; AICPA, GOOD TAX POLICY, *supra* note 228, at 7.

299. *See* Mueller, *supra* note 228; AICPA, GOOD TAX POLICY, *supra* note 228, at 7.

300. *See* Mueller, *supra* note 228; AICPA, GOOD TAX POLICY, *supra* note 228, at 8.

301. *See* Moore, *When Will Congress Intervene?*, *supra* note 2, at 205; Moore, *The Second Best Solution*, *supra* note 1, at 1429–36.

302. Moore, *When Will Congress Intervene?*, *supra* note 2, at 205.

303. Hazen, *supra* note 291, at 1040; Moore, *When Will Congress Intervene?*, *supra* note 2, at 205.

304. Hazen, *supra* note 291, at 1023–24.

declined to impose its will in the field of interstate taxation,[305] instead deferring to Congress "out of ostensible respect for the separation of powers doctrine."[306] This circuitous loop of congressional stagnation and Supreme Court deference to Congress renders the idealistic vision for state and local taxation uniformity impractical and out of reach for the time being.[307]

With uniformity likely off the table, Professor Kathryn Moore, a prominent tax scholar at the University of Kentucky Rosenberg College of Law, has suggested an alternative idea, dubbed the "second best solution."[308] This approach modifies Justice Scalia's proposed two-prong test for challenges to state taxes under the dormant Commerce Clause, where "the Court should only strike down a state taxing statute if: (1) the statute facially discriminates against interstate commerce; or (2) the statute is indistinguishable from a statute the Court has previously stricken."[309] While Moore acknowledges the possible shortcomings in this solution's architecture, this approach has the potential to prevent state taxing statutes from causing "the most egregious drags on our national economy" and would also promote confidence and clarity in the tax system.[310]

Even so, this "second best solution" injects further uncertainty into an already uncertain system.[311] As Moore points out, reasonable minds can differ as to whether a taxing statute is facially discriminatory.[312] Perhaps the most practical solution is the one already before us: abiding by the Supreme Court's precedent in *Wynne*.[313] Though a far cry from the idealistic fantasy of uniformity, by having courts analyze a state's tax scheme as a whole, including taxes levied by its political subdivisions and without regard to the state's own labeling of such taxes, the fair apportionment and discrimination issues that plagued the *Zilka II* tax regime would suddenly disappear.[314]

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305. *See* Auxier, *supra* note 248.

306. Hazen, *supra* note 291, at 1023–24.

307. *See id.*; Moore, *The Second Best Solution*, *supra* note 1, at 1467–68 (attributing the Supreme Court's reluctance to weigh in on interstate commerce issues in state and local taxation due to a lack of institutional competence).

308. Moore, *The Second Best Solution*, *supra* note 1, at 1428.

309. *Id.* The author goes on to explain:

> In applying the first prong, the Court should only look beyond the face of the statute at issue to determine whether a facially discriminatory statute should be saved as a compensating tax. The court should narrowly define compensating taxes as functionally equivalent taxes. In applying the second prong, the Court should first ask whether the Court has ever stricken a functionally equivalent tax. If it has not, then it should uphold the statute. In determining whether the Court has stricken a functionally equivalent tax, the Court should take into account parties' expectations. When applying the prong, the Court should make every effort to announce clear and certain rules that further stability.

Id. at 1504.

310. *Id.* at 1428.

311. *See id.* at 1492–93.

312. *See id.*

313. *See* Comptroller of the Treasury v. Wynne, 575 U.S. 542, 564 n.8 (2015).

314. *See id.*; *Zilka II*, Nos. 1063 C.D. 2019, 1064 C.D. 2019, 2022 WL 67789, at *5–6 (Pa. Commw. Ct. Jan. 7, 2022), 272 A.3d 991 (unpublished table decision).

Because remote work exposes more taxpayers to the problems evident in *Zilka II*, stricter obedience to *Wynne* by the courts may offer the only solution that can be implemented swiftly enough to avoid further litigation and incremental deadweight losses.[315]

VI. Conclusion

State and local taxation is anything but straightforward, especially in the interstate context.[316] Considering the long, windy legal history of the dormant Commerce Clause and its intersection with state taxation,[317] and particularly in light of the Supreme Court's silence on the matter,[318] it is no wonder that both taxpayers and courts are filled with uncertainty.[319]

Even so, the *Zilka II* court missed the mark.[320] The court failed to adequately address the case's constitutional issues, misapplying both the *Complete Auto* framework and the Supreme Court's precedent in *Wynne*.[321] And even if it is constitutional, the challenged tax scheme promotes unsound tax policy,[322] particularly with the rise of remote work in the aftermath of the COVID-19 pandemic.[323]

Potential solutions are few and far between.[324] Though uniformity would theoretically clear up many of the issues plaguing state and local taxation, in reality, it may just be a pipe dream.[325] Other proposed solutions may be even more complicated than the actual problem itself.[326] Until the Supreme Court or Congress intervenes, consistent application of the limited Supreme Court precedent by lower courts is likely the best we can hope for.[327]

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315. *See Wynne*, 575 U.S. at 564 n.8; *Zilka II*, 2022 WL 67789, at *5–6; *see also* Mueller, *supra* note 228; AICPA, GOOD TAX POLICY, *supra* note 228, at 3.

316. *See* Moore, *The Second Best Solution*, *supra* note 1, at 1426.

317. See *supra* Part III.A–B for a discussion of the evolution of the dormant Commerce Clause, both generally and related to state taxation.

318. See *supra* Part V.C for an analysis of the Supreme Court's decision to deny review of *New Hampshire v. Massachusetts*.

319. *See* Auxier, *supra* note 248.

320. *See Zilka II*, 2022 WL 67789, at *5–6.

321. See *supra* Part V.A for a discussion of the court's failure to sufficiently address the constitutional problems presented in the case.

322. See *supra* Part V.B for an analysis of the *Zilka II* tax scheme's policy defects.

323. *See* Robinson, *supra* note 5.

324. See *supra* Part V.D for a walkthrough of the potential solutions to resolving the foundational issues in state and local taxation.

325. *See* Moore, *When Will Congress Intervene?*, *supra* note 2, at 205; Moore, *The Second Best Solution*, *supra* note 1, at 1429–37.

326. *See* Moore, *The Second Best Solution*, *supra* note 1, at 1428–29.

327. *See* Comptroller of the Treasury v. Wynne, 575 U.S. 542, 564 n.8 (2015); Hazen, *supra* note 291, at 1023–24; Moore, *The Second Best Solution*, *supra* note 1, at 1467–68.