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REGULATING BY CONTRACT: A FUNCTIONS-BASED APPROACH TO ANTI-ESG LAWS

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With the rise of stakeholder capitalism since the turn of the century, companies have adopted policies and practices related to environmental, social, and governance (ESG) issues. Parties wishing to do business with such companies are often required to agree to contract provisions related to these ESG policies, such as committing to reduce their greenhouse gas emissions. In response to this emerging corporate practice, Texas and other conservative states have taken the opposite approach and adopted anti-ESG laws that prohibit vendors from boycotting the oil and gas industry. This use of the states' contracting power to push a political agenda sits at the divide between market participation protected by the Market Participant Exception, and market regulation subject to Dormant Commerce Clause scrutiny. Both the Dormant Commerce Clause and the Market Participant Exception doctrines are functional doctrines created by courts to protect important but competing constitutional values. Although the Market Participant Exception is often summarized as the idea that a government can do whatever a private party could do when buying or selling goods and services (i.e., participating in the market), the constitutional values at risk require courts to take a more nuanced approach.

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This Article proposes a new functions-based test to use when evaluating whether a provision in a government contract is market participation or regulation. It categorizes contract provisions by their functions vis-à-vis the parties' proprietary interests implicated by the contract. It then connects each category to relevant precedent and discusses the constitutional values served or put at risk by each category. By connecting constitutional values to contractual function, this approach permits courts to better delineate between the kinds of state actions that should be shielded from intervention and those that deserve to be scrutinized by the courts. The Article ultimately concludes that anti-ESG provisions in government contracts are far too attenuated from the state's proprietary interests to deserve blanket immunity from Dormant Commerce Clause scrutiny.

INTRODUCTION

This Article begins with a discussion of the trend among corporations to protect stakeholders' interests by requiring environmental, social, and governance (ESG) provisions in contracts, rather than simply protecting the company's own proprietary interests. Examples of such provisions include

requiring a supplier to reduce its greenhouse gas emissions each year and comply with ethical sourcing programs. It also discusses the history of and response by conservative states who have passed anti-ESG laws prohibiting vendors from boycotting certain industries, including fossil fuel and agriculture companies. Part I further explains the various forms and examples of anti-ESG laws both passed and contemplated by state legislatures.

Part II discusses the history and status of the Dormant Commerce Clause and, in particular, the important constitutional values the Court's Dormant Commerce Clause rulings are meant to protect—avoiding balkanization, promoting national unity, and protecting a unified national market. It also discusses the Market Participant Exception to the Dormant Commerce Clause and the competing values it protects—respecting state sovereignty, protecting state assets, incentivizing states to build local economies, and encouraging competition amongst states. Finally, it describes the tests that circuit courts currently apply to determine whether state action is market participation or regulation.

The Article then posits a new framework for categorizing contract provisions for purposes of applying the Market Participant Exception. In deciding whether the Market Participant Exception applies, courts must determine whether a state action is proprietary—action that serves the government's own best interests—or regulatory—action that serves the public interest; courts have come up with different tests. Rather than a balancing test with a binary result, the proposed framework creates categories of contract provisions based on the provision's function in the contract vis-à-vis the parties' proprietary interests in the transaction. Part III also analyzes each category's impact on Dormant Commerce Clause and Market Participant Exception values.

To end, Part IV applies the framework to a sample contract between Texas and a private party, identifying examples of each kind of provision and the role it plays in the transaction. It concludes that anti-ESG provisions—at least in the form passed by numerous states—are too far removed from the proprietary interests protected by the Market Participant Exception and should therefore be subject to Dormant Commerce Clause scrutiny.

I.
ESG and Anti-ESG Trends

In the century-long battle over the proper scope of a corporation's purpose,[1] stakeholder capitalism is having its moment.[2] As used in this Article, stakeholder capitalism, or stakeholderism, is the idea that business leaders should make decisions that benefit not just shareholders but also other stakeholders—including employees, customers, and the environment.[3] The modern era of stakeholderism is in response to the shareholder capitalism that rose to prominence in the 20th century.[4] Maximizing shareholder value was seen as the most important—and perhaps exclusive—goal of corporate decisionmakers.[5] As the corporate form has evolved in the United States, so have the goals of its leaders.

In their earliest form, American corporations were chartered by the government only to provide specific public benefits.[6] The key feature of the corporation—limited liability—"was an extraordinary and undemocratic privilege, and only a prevailing public interest could justify it."[7] Over time, the benefits of the corporate form were opened up to anyone who wanted them, and the original public purpose of the corporate form gave way to "the idea that the main purpose of the business corporation was to make profits for shareholders . . . ."[8]

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1. *See generally*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247, 257–65 (1999) (citing Ronald H. Coase, *The Nature of the Firm*, 4 Economica 386 (1937), *reprinted in* The Nature of the Firm: Origins, Evolution, and Development 18, 20 (Oliver E. Williamson & Sidney G. Winter eds., 1991); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 Harv. L. Rev. 1145, 1146 (1932).

2. *See Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, Bus. Roundtable (Aug. 19, 2019), https://opportunity.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

3. *See* Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 Cornell L. Rev. 91, 93–95 (2021).

4. Stakeholderism—or at least the notion that corporations were primarily for the public good—actually predates shareholderism. However, the modern push for stakeholderism is at least in part a response to the perceived failures of decades of shareholder primacy. *See id.* at 103–07.

5. *See* Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. Times, Sept. 13, 1970, at SM17.

6. John A. Powell & Stephen Menendian, *Beyond Public/Private: Understanding Excessive Corporate Prerogative*, 100 Ky. L.J. 83, 89 (2001).

7. Bebchuk & Tallarita, *supra* note 3, at 103.

8. *Id.*

Shareholder primacy was assumed by management,[9] enshrined into law by courts,[10] and built into the structure of the corporate form.[11] Although it has been eroded at the margins, shareholderism has been a key feature of corporate law since the 1920s.[12]

Stakeholderism has had its advocates throughout the evolution of the corporate form,[13] though the last twenty years has seen a marked push for formalizing and actualizing stakeholder economics.[14] Although ESG requirements are not universal, many companies use ESG metrics when choosing suppliers.[15] Pressure from investors and corporate buyers to increase supply chain transparency and accountability has substantially increased.[16] States have also begun to adopt regulations requiring supply chain transparency.[17]

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9. *See* Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 Bus. Law. 363, 381 (2021).

10. *See* Bebchuk & Tallarita, *supra* note 3, at 103 (citing *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919)).

11. *See generally* Rock, *supra* note 9, at 372 (explaining that, in traditional jurisdictions, shareholder primacy—even if not explicitly required—is the norm based on "the statutory structure, the case law, and the history of reform efforts in and out of Delaware."); *see* Bebchuk & Tallarita, *supra* note 3, at 92. Importantly, the advent of benefit corporations—special corporations that explicitly permit decisionmakers to consider factors other than shareholder returns—supports the idea that shareholder primacy was the default. *See* Dustin Womack, *Solely Beneficial: How Benefit Corporations May Change the Duty of Care Analysis for Traditional Corporate Directors in Delaware*, 8 Mich. Bus. & Entrepreneurial L. Rev. 151, 156–57 (2018).

12. *See* Bebchuk & Tallarita, *supra* note 3, at 103–108.

13. *Id.* at 104 (citing Dodd, *supra* note 1, at 1147).

14. *See* Reete Rool, *From Social Responsibility to Better Operational Resiliency: Why You Should Care About ESG*, TBL, https://tbl-services.com/the-rise-of-esg/ (last visited Feb. 19, 2025).

15. *See* Vivek Ghelani & Marisa Brown, *Bridging the ESG Gap in Supply Chain Management: From Ambition to Action*, Supply Chain Mgmt. Rev. (Apr. 29, 2024), https://www.scmr.com/article/bridging-the-esg-gap-in-supply-chain-management-from-ambition-to-action.

16. MIT Ctr. for Transp. & Logistics, State of Supply Chain Sustainability 2024 4 (2024), https://sustainable.mit.edu/wp-content/uploads/2024/10/2024_State-Sustainable-Supply-Chains-MIT-CSCMP-1.pdf.

17. *See, e.g.*, *The California Transparency in Supply Chains Act*, State Cal. Dep't Just. Off. Att'y Gen., https://oag.ca.gov/SB657 (last visited Feb. 19, 2025). Not surprisingly, the European Union has adopted a comprehensive law requiring extensive corporate due diligence on supply chains. European Parliament Resolution of 10 March 2021 with Recommendations to the Commission on Corporate Due Diligence and Corporate Accountability, 2021 O.J. (C 474/11), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021IP0073&qid=1742855724166.

In the private sector, Microsoft's vendor program is illustrative. Microsoft has affirmatively committed to be carbon negative by 2030.[18] To achieve that goal, Microsoft requires "its suppliers to reduce their total emissions (Scope 1, 2, and 3) by fifty-five percent compared to a 2019 baseline,"[19] as well as "[t]ransition to 100% carbon-free electricity for their Microsoft delivered goods and services by 2030 . . . ."[20] Microsoft imposes these obligations on its suppliers in their written agreements with those suppliers[21] and in enforcing its Supplier Code of Conduct.[22] The company also requires its suppliers to impose the same obligations on the suppliers' "subcontractors and subtier suppliers . . . in their operations and across their supply chains for work that is directly related to a Microsoft contract."[23] Failure to comply with these obligations may lead to termination of the agreement.[24] To be clear, the Supplier Code of Conduct is not simply a restatement of legal obligations that are already applicable to the supplier.[25] The Code "may go beyond legal compliance in order to advance social and environmental responsibility and business ethics."[26]

ESG-focused initiatives like Microsoft's have become a part of the mainstream for private businesses both domestically and abroad. Eighty-one percent of respondents from a 2021

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18. Brad Smith, *Microsoft Will Be Carbon Negative by 2030*, MICROSOFT (Jan. 16, 2020), https://blogs.microsoft.com/blog/2020/01/16/microsoft-will-be-carbon-negative-by-2030/.

19. MICROSOFT, DEVELOPING A SUSTAINABLE PROCUREMENT STRATEGY 5 (2022), https://download.microsoft.com/download/0/8/1/081afcd1-9429-490c-aa2a-80e56adde2e6/Developing_a_%20Sustainable_Procurement_Strategy.pdf.

20. MICROSOFT, MICROSOFT SUPPLIER CODE OF CONDUCT 14 (2024), https://cdn-dynmedia-1.microsoft.com/is/content/microsoftcorp/microsoft/accex/documents/presentations/Microsoft%20Supplier%20Code%20of%20Conduct.pdf.

21. *Id.*

22. *Id.* at 1 ("Suppliers and their employees, personnel, agents, subcontractors, and sub-tier suppliers (collectively referred to as 'Suppliers') shall adhere to this Supplier Code of Conduct while conducting business with or on behalf of Microsoft.").

23. *Id.* at 1–2.

24. *Id.* at 2 ("Suppliers that behave in a manner that is unlawful or inconsistent with the [Supplier Code of Conduct], or any Microsoft policy, risk termination of their business relationship with Microsoft.").

25. *See, e.g.*, *id.* at 2 ("Suppliers shall comply with all laws and regulations applicable to the import or export of the Items, including but not limited to trade laws and sanctions regulations.").

26. *Id.* at 2.

survey—large business leaders from the United States, United Kingdom, France, and Germany—indicated that their businesses employs some formal ESG program like Microsoft's.[27] The vast majority of large business leaders view sustainability and ESG factors as "extremely important" to their companies' longevity.[28] Importantly, these measures are likely due, at least in part, to consumer-based market forces. ESG considerations have become a part of the individual consumer's calculus when commercially interacting with businesses and an overwhelming majority of executives have indicated that they "feel pressure" to pursue ESG initiatives.[29]

The rise of sustainability and ESG considerations in contracting by businesses has created a Newtonian reaction at various levels of government in the United States. As part of a recent trend, states have adopted laws requiring their contracting counterparts to pledge that they do not and will not engage in certain behaviors.[30]

The Boycott, Divestment, Sanction ("BDS") movement—started by the Palestinian civil society in 2005 and inspired by the South African anti-apartheid movement[31]—called for governments and private entities to distance themselves from

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27. *Global Survey Finds Businesses Increasing ESG Commitments, Spending*, NAVEX, Inc. (Feb. 23, 2021), https://www.navex.com/en-us/blog/article/environmental-social-governance-esg-global-survey-findings/.

28. *See* Ernst & Young LLP, C-suite Insights: Sustainability and ESG Trends Index 2 (2023), https://www.ey.com/content/dam/ey-unified-site/ey-com/en-us/campaigns/masters-sustainability/documents/ey-c-suite-insights-sustainability-and-esg-trends-index.pdf (finding that 87% of major U.S. business leader respondents believed that their companies' ESG initiatives are "very to extremely important to their businesses and long-term success.").

29. Adam Zaki, *94% of CFOs, Executives Feel Pressure to Prioritize ESG*, CFO (May 31, 2023), https://www.cfo.com/news/94-of-cfos-executives-feel-pressure-to-prioritize-esg/654493/; *see Beyond Compliance: Consumers and Employees Want Business to Do More on ESG*, PwC (2021), https://www.pwc.com/us/en/services/consulting/library/consumer-intelligence-series/consumer-and-employee-esg-expectations.html (finding that eighty-three percent of surveyed consumers believe that companies should play an active role in "shaping ESG best practices," and that companies' participation in considering ESG factors affects the likelihood of consumption for seventy-six to eighty percent of them).

30. *See, e.g.*, *US: States Use Anti-Boycott Laws to Punish Responsible Businesses*, Hum. Rts. Watch (Apr. 23, 2019), https://www.hrw.org/news/2019/04/23/us-states-use-anti-boycott-laws-punish-responsible-businesses.

31. *See What is BDS?*, Palestinian BDS Nat'l Comm., https://bdsmovement.net/what-is-bds (last visited Feb. 20, 2025).

Israel and Israeli companies.[32] In the United States, the BDS movement gained some notable corporate adherents.[33] State governments, on the other hand, have overwhelmingly rejected the BDS movement; as of February 2024, thirty-eight states have adopted some sort of law opposing the BDS movement.[34] The states that have adopted anti-BDS laws are politically,[35] geographically, and economically diverse.[36]

Although the particulars vary by state, most state anti-BDS laws prohibit public entities from signing a contract with a prohibited company (No Contracts), require public entities to divest themselves from prohibited companies (Divestment), or both.[37] Texas's No Contracts law is exemplary. It prohibits a governmental entity from entering "into a contract with a company for goods or services unless the contract contains a written verification from the company that it: (1) does not boycott Israel; and (2) will not boycott Israel during the term of the contract."[38] Texas defines boycotting Israel as:

> [R]efusing to deal with, terminating business activities with, or otherwise taking any action that is intended to penalize, inflict economic harm on, or limit

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32. *See id.*; Manal Juma, *Analyzing Constitutionality of Anti-BDS Laws: Individual Rights Versus State Interests*, 47 Nova L. Rev. 225, 228 (2023).

33. *See, e.g.*, *Companies that Boycott Israel in Violation of State Laws by State*, Jewish Virtual Libr. (2021), https://www.jewishvirtuallibrary.org/companies-that-boycott-israel-in-violation-of-state-laws-by-state.

34. *Anti-Semitism: State Anti-BDS Legislation*, Jewish Virtual Libr., https://www.jewishvirtuallibrary.org/anti-bds-legislation (last visited Feb. 20, 2025).

35. *Compare* Cal. Pub. Cont. Code § 2010 (West 2017), *with* Utah Code Ann. § 63G-27-201 (West 2023). Both chambers of the California legislature and the governorship have been controlled by Democrats since 2011, and those of Utah have been controlled by Republicans since 1985. *State Government Trifectas*, Ballotpedia, https://ballotpedia.org/State_government_trifectas (last visited Mar. 24, 2025).

36. Tex. Gov't Code Ann. § 808 (West 2017); *Id.* § 2271 (West 2019); S.D. Exec. Order No. 2020-01 (2020), https://sdsos.gov/general-information/executive-actions/executive-orders/assets/2020-01.PDF. *Compare* David Green & Dan Olsen, *Texas GDP on the World Stage*, Tex. Comptroller (June 2024), https://comptroller.texas.gov/economy/fiscal-notes/economics/2024/big-map/ (Texas's 2022 GDP was $2.4T.), *with What is the Gross Domestic Product (GDP) in South Dakota?*, USAFacts, https://usafacts.org/answers/what-is-the-gross-domestic-product-gdp/state/south-dakota/ (Feb. 15, 2025) (South Dakota's 2023 GDP was $57.3B.).

37. *See* Marc A. Greendorfer, *Boycotting the Boycotters: Turnabout Is Fair Play Under the Commerce Clause and the Unconstitutional Conditions Doctrine*, 40 Campbell L. Rev. 29, 31 (2018).

38. Tex. Gov't Code Ann. § 2271.002 (West 2019).

> commercial relations specifically with Israel, or with a person or entity doing business in Israel or in an Israeli-controlled territory, but does not include an action made for ordinary business purposes.[39]

In addition to requiring contracting parties to agree contractually not to boycott Israel, the law also requires the comptroller to create and distribute a list of offending companies.[40] In making the list, "the comptroller may review and rely, as appropriate in the comptroller's judgment, on publicly available information regarding companies, including information provided by the state, nonprofit organizations, research firms, international organizations, and governmental entities."[41] There is no private right of action for parties harmed by state actors pursuant to this law.[42]

Numerous challenges to anti-BDS laws have been working their way through courts.[43] Those challenges primarily argue that No Contracts laws impermissibly compel speech and restrict plaintiffs right to free expression under the First Amendment.[44] Some litigants have argued the anti-BDS laws violate the Dormant Commerce Clause.[45] However, those Dormant Commerce Clause challenges have been dismissed on other grounds.[46] The U.S. Supreme Court recently declined to take up a case involving Arkansas's No Contracts law.[47] That left in place the Eighth Circuit's conclusion that the law did not violate the First Amendment.[48]

Although courts have not substantively taken up a Dormant Commerce Clause challenge to the anti-BDS laws, at least one commentator has concluded that, "looking at the [states' anti-BDS laws] under the Market Participant Doctrine, it is clear

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39. Tex. Gov't Code Ann. § 808.001 (West 2017).
40. *Id.* § 808.051.
41. *Id.*
42. *Id.* § 808.004 (West 2017).
43. *See, e.g.*, Amawi v. Pflugerville Indep. Sch. Dist., 373 F. Supp. 3d 717 (W.D. Tex. 2019), *rev'd*, Amawi v. Paxton, 48 F.4th 412 (5th Cir. 2022).
44. *See, e.g.*, Jordahl v. Brnovich, 789 F. App'x 589, 591 (9th Cir. 2020).
45. *See, e.g.*, Abdullah v. Paxton, No. 1:20-CV-1245-RP, 2021 WL 5181614 (W.D. Tex. Nov. 8, 2021).
46. *See, e.g.*, *id.* at *8 (dismissing plaintiff's Dormant Commerce Clause challenge for lack of standing).
47. Ark. Times LP v. Waldrip, 37 F.4th 1386, 1386 (8th Cir. 2022) (en banc), *cert. denied*, Ark. Times LP v. Waldrip, 143 S. Ct. 774.
48. *Id.*

that these laws do not violate the Commerce Clause."[49] The argument is that when the state is acting as a trader—such as when it is offering contracts to purchase goods or services—it "has the same right to make business decisions as any private party would."[50] The conclusion is also supported by the belief that a state should not be "compelled to do business with a party that offends the ideological interests of the state's citizens if the party happens to be the lowest bidder for a contract."[51]

Importantly, state anti-BDS laws are consistent with federal law and policy. The United States-Israel Free Trade Agreement actively promotes trade and investment in Israel.[52] The U.S. Government itself provides Israel with more than $3 billion in military financing annually.[53] At the very least, a federal policy *encouraging* commercial activity with Israel is consistent with state laws *discouraging* companies from boycotting Israel.[54] Although an explicit[55] anti-BDS federal law has yet to be passed by both houses, legislators have overwhelmingly voted in favor of anti-BDS measures. In 2019, the House adopted by a vote of 398 to 17 a resolution that stated the House "opposes the Global Boycott, Divestment, and Sanctions Movement (BDS Movement) targeting Israel, including efforts to target United States companies that are engaged in commercial activities that are legal under United States law, and all efforts to delegitimize the State of Israel . . . ."[56] In 2019, the Senate passed by a vote of 77 to 23 a bill that would have ensured federal law did not preempt state anti-BDS laws.[57] In 2023, a group of Senators, led

49. Greendorfer, *supra* note 37, at 41.

50. *Id.* at 39.

51. *Id.* at 40.

52. Israel Free Trade Agreement, Isr.-U.S., Aug. 19, 1985, 99 Stat. 82. The Preamble specifies that one of the purposes of the Act is to "strengthen and develop the economic relations" between the United States and Israel.

53. *Policy & History*, U.S. Embassy in Isr., https://il.usembassy.gov/our-relationship/policy-history/ (last visited Feb. 11, 2025).

54. Although No Contract laws do not compel a private party to do business with Israel, such laws were certainly adopted with the policy goal of discouraging companies from doing so. *See, e.g.*, Press Release, Greg Abbott, Governor, Texas, Anti-Israel Policies Are Anti-Texas Policies (May 2, 2017), https://gov.texas.gov/news/post/anti-israel-policies-are-anti-texas-policies.

55. *See* Greendorfer, *supra* note 37, at 31 (citing Export Administration Act of 1979 § 8 (2012) (current version at 50 U.S.C. § 2407) (not specifically addressing Israel).

56. H.R. 246, 116th Cong. (2019).

57. Strengthening America's Security in the Middle East Act of 2019, S.1, 116th Cong. (2019), https://www.congress.gov/bill/116th-congress/

by now-Secretary of State Marco Rubio, reintroduced the Combating BDS Act.[58]

Following the successful passage of anti-BDS laws, states began passing laws aimed at discouraging boycotts of other industries. Texas was the first state to adopt an anti-boycott bill aimed at protecting the fossil fuel industry.[59] Led by a former legislator at a conversative think tank,[60] Texas quickly took up and passed a bill that was virtually identical to that state's anti-BDS law, except that "Israel" was replaced with "energy companies."[61] Similar to the No Contracts provision of the anti-BDS law,[62] the No Contracts provision of the anti-boycott law prohibits state agencies from entering into contracts with any company that "boycotts" the fossil fuel industry.[63] The law's definition of boycott is broadly drawn to include everything from a categorical refusal to do business with fossil fuel companies to "otherwise taking any action that is intended to . . . limit commercial relations" with a fossil fuel company.[64] Not only are direct boycotts of fossil fuel companies prohibited, but vendors

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senate-bill/1/all-actions. The House did not take up the Combating BDS Act of 2019.

58. Press Release, Marco Rubio, U.S. Senator, Senate, Rubio, Colleagues Reintroduce Legislation to Combat Anti-Israel BDS Campaign (May 18, 2023), https://www.rubio.senate.gov/rubio-colleagues-reintroduce-legislation-to-combat-anti-israel-bds-campaign/ [web.archive.org/web/20230924010035/https://www.rubio.senate.gov/rubio-colleagues-reintroduce-legislation-to-combat-anti-israel-bds-campaign/].

59. Leah Malone et al., Simpson Thacher & Bartlett, LLP, ESG Battlegrounds: How the States Are Shaping the Regulatory Landscape in the U.S. 1 (Feb. 5, 2024); *see* Tex. Gov't Code Ann. § 2276.002 (West 2023).

60. Chris McGreal, *ALEC Is Driving Laws to Blacklist Companies That Boycott the Oil Industry*, Nation (Feb. 8, 2022), https://www.thenation.com/article/environment/alec-climate-change-big-oil/.

61. *Compare* Tex. Gov't Code Ann. § 808 (West 2017) (prohibiting investment in companies that boycott Israel), *with id.* § 809 (West 2021) (prohibiting investment in financial companies that boycott certain energy companies). The law also changed the target of the divestment requirement to "financial companies," rather than all companies. *Compare id.* §§ 808.001(2), 808.051 (West 2017) (defining "companies" for the scope of prohibition related to Israel), *with id.* §§ 809.001(2), 809.051 (West 2021) (defining "financial companies" for the scope of prohibition related to the fossil fuel industry).

62. Tex. Gov't Code Ann. § 2271.002 (West 2019).

63. Tex. Gov't Code Ann. § 2276.002 (West 2023).

64. Tex. Gov't Code Ann. § 809.001(1) (West 2021) (defining "boycott energy company" with regards to investments); *see also* Tex. Gov't Code Ann. § 2276.001(1) (West 2023) (defining "boycott energy company" with regards to state and local contracts by referencing Section 809.001).

are also prohibited from "boycotting" any non-fossil fuel company that does business with fossil fuel companies.[65] The law applies to *any* "goods or services" associated with the contract and are not limited to professional or financial services.[66] It also applies to all contract amendments and renewals after the effective date.[67]

The history behind Texas's anti-boycott law shows the law was motivated by economic protectionism and intended to shield Texas oil and gas companies from market forces; the lead sponsor of the law made clear that the law was meant to send "a strong message to big business: If you boycott Texas energy, Texas will boycott you."[68] Texas's comptroller said his actions under the new law came "at a time when Texas oil and natural gas should be playing a key role in supporting the American economy . . . ."[69]

Texas's anti-boycott law serves as just one of many examples of anti-ESG legislation that would come to pass or be considered in some fashion—both by Texas and other states nationwide.[70] From this legislative wave, six primary subcategories of anti-ESG legislation have arisen along with the creation of such legislation.[71] These laws either: prohibit the state from entering contracts with entities that consider ESG factors or boycott certain industries; prohibit state investment in or require divestment from entities that that consider ESG factors or boycott certain industries; prohibit proxy voting by shareholders in

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65. Tex. Gov't Code Ann. § 809.001(1)(B) (West 2021).

66. *See* Tex. Gov't Code Ann.§ 2276.002(b) (West 2023).

67. *See* S.B. 13, 87th Legis. Sess. (Tex. 2021).

68. Phil King, *Texas Is Standing up to Wall Street's Anti-Energy Agenda*, Tex. Pub. Pol'y Found. (June 16, 2021), https://www.texaspolicy.com/texas-is-standing-up-to-wall-streets-anti-energy-agenda/.

69. Press Release, Glenn Hagar, Comptroller, Texas, Texas Comptroller Glenn Hegar Seeks Information from 19 Companies That May be Boycotting Fossil Fuel Industry (Mar. 16, 2022), https://comptroller.texas.gov/about/media-center/news/20220316-texas-comptroller-glenn-hegar-seeks-information-from-19-companies-that-may-be-boycotting-fossil-fuel-industry-1647296122533.

70. Shortly after Texas passed their first anti-ESG law in 2021, Pleiades Strategy—a company specializing in climate policy research—began documenting all anti-ESG legislation that began to arise among the states. *See Live Anti-ESG State Action Tracker*, Pleiades Strategy, https://www.pleiadesstrategy.com/pleiades-anti-esg-bill-tracker-state-legislation-attacks-on-responsible-investing (last visited Feb. 11, 2025).

71. *See id.* As a part of this documenting effort, Pleiades has organized these laws into subcategories based on their function and effect.

state investment entities to not consider ESG factors; prohibit the practice of scoring entities based on ESG factors—whether by the state or as private parties; create civil liability for entities that boycott other entities for ESG purposes or consider ESG factors when deciding to engage with other entities; or allow state entities to deem federal rules that would require the state to consider ESG factors unconstitutional and not follow them.[72]

Texas's anti-boycott law described above fits squarely into the first category—laws that prohibit the state from contracting with parties that boycott the fossil fuel industry.[73] Texas enacted a separate law alongside this legislation, which simultaneously expanded the prohibition on contracts to companies that boycott the firearm and ammunition manufacturing industry using largely the same structure.[74] Some states have limited the types of entities to be impacted by similar laws, and others have expanded the behaviors of companies subject to the company's boycott that trigger the state's contractual prohibition.[75]

Texas's first anti-ESG law was double-headed. Along with the prohibition on contracts with boycotting companies, Texas also prohibited investment and required divestment by the state in such companies and established the procedure to identify them.[76] Many states enacting anti-ESG legislation likely used Texas as a playbook, as they used similar structures of passing contractual anti-boycott laws alongside, or in addition to, these investment/divestment anti-boycott laws.[77]

States have also sought to limit the considerations parties can make with regard to certain investment or business-like decision-making actions. Some have statutorily mandated proxy voters for shareholders in certain state investment programs to

72. *See id.*

73. *See* Tex. Gov't Code Ann. § 2276.002 (West 2023); *see also* Tex. Gov't Code Ann. § 809.001(1) (West 2021).

74. *Compare* Tex. Gov't Code Ann. §§ 2274.001–.002 (West 2023) (prohibiting contracting with companies that boycott the firearm and ammunition manufacturing industry), *with id.* §§ 2276.001–.002 (West 2023) (prohibiting investment in financial companies that boycott certain energy companies).

75. *See, e.g.*, W. Va. Code § 12-1C (2022) (subjecting only banking and other financial institutions to their contractual anti-boycott statute); Utah Code Ann. § 63G-27-102 (West 2023) (including entities that boycott companies which "do[] not facilitate or commit to facilitate access to abortion or sex characteristic surgical procedures" as a qualification for the state's contractual anti-boycott law).

76. *See* S.B. 13, 87th Legis. Sess. (Tex. 2021).

77. *See, e.g.*, Okla. Stat. tit. 113, § 12001–06 (2022).

make no consideration to ESG factors, and only mind pecuniary aspects, in the exercise of their voting power.[78] Others have banned the practice of scoring certain companies for their compliance with ESG factors and have done so for both private and public entities.[79]

In addition, states have gone as far as to create civil liability for boycotting certain industries based on ESG factors or even considering them when deciding to engage with businesses. Under the framework of anti-discriminatory business practice legislation, Tennessee and Florida have created pathways for businesses to report other businesses who they suspect are not engaging with them due to poor ESG compliance and subject those boycotting businesses to civil liability pursuant to Tennessee's financial regulatory code and Consumer Protection Act and Florida's Deceptive and Unfair Trade Practices Act.[80]

Likely in response to President Biden's desire to bolster the federal government's ESG compliance, as evinced by the passing of executive orders to accomplish such,[81] some states have provided procedures to oppose any federally mandated ESG compliance.[82] Specifically, these states have charged their legislatures and attorneys general with the duty and ability to determine such federal ESG regulations constitutionally suspect and to not have them enforced if they are determined as such.[83]

States have also passed other types of anti-ESG laws that do not fit into the above-mentioned categories. One has imputed the requirement to not consider ESG factors in the

78. *See, e.g.*, Ga. Code. Ann. § 47-20-88 (2024).

79. *See, e.g.*, Tex. Ins. Code Ann. § 565.005 (West 2023); Utah Code Ann. § 63G-29-201 (West 2023).

80. *See* Tenn. Code Ann. § 45-1-128 (West 2024); Fla. Stat. § 655.0323 (West 2024).

81. *See* Exec. Order No. 14,030, 86 C.F.R. 27,967 (2021); Exec. Order No. 14,057, 86 C.F.R. 70,935 (2021); Exec. Order No. 14,096, 88 C.F.R. 25,251 (2023).

82. *See, e.g.*, Okla. Stat. tit. 80, § 101 (2021). Of the states that have successfully passed this type of anti-ESG legislation, all of them did so using much of the same language for the parts that provided the legislature-attorney general constitutionally suspect determination procedure. *Compare* H.B. 1236, 58th Leg., Reg. Sess. (Okla. 2021), *and* H.B. 1164, 67th Leg., Reg. Sess. (N.D. 2021), *and* S.B. 277, 67th Leg., Reg. Sess. (Mont. 2021), *with* H.B. 1637, 93d Gen. Assemb., Reg. Sess. (Ark. 2021).

83. *See, e.g.*, Okla. Stat. tit. 80, § 101 (2021).

decision-making processes for regional utility authorities,[84] another has required reports promulgated by their treasury pension and investment fund managers to specifically note whether investment motivations included any interests outside pecuniary ones,[85] and one has prohibited multiple companies from conspiring against any boycotted companies to prevent them from obtaining products or services necessary to carry out their business.[86]

Unlike anti-BDS laws that were passed by red and blue states on a bipartisan basis, anti-boycott laws have only been passed by Republican-controlled states.[87] The Anti-ESG movement is part of an organized, partisan campaign against so-called "woke" capitalism.[88] A group of five Republican senators threatened large law firms with congressional hearings of the firms' clients' ESG policies, arguing that "[t]he ESG movement attempts to weaponize corporations to reshape society in ways that Americans would never endorse at the ballot box."[89] The irony, of course, is that conservative states, in using "economic force to control behaviors to drive a political agenda," are doing exactly what they accuse corporations of doing.[90] The key difference, though, is that states are subject to the restrictions of the Commerce Clause when seeking to influence interstate commerce.

II.
The Dormant Commerce Clause

State action that impacts interstate commerce is limited by the Dormant Commerce Clause doctrine. The Dormant Commerce Clause provides an important check on state action

84. *See* H.B. 1645, 2023 Leg., Reg. Sess. (Fla. 2023).
85. *See* N.H. Rev. Stat. Ann. § 100-A:15(VIII)(b) (2023).
86. *See* Utah Code Ann. § 13-66-201 (West 2023).
87. *See* Pleiades Strategy, *supra* note 70.
88. *See* Ross Douthat, *The Rise of Woke Capital*, N.Y. Times (Feb. 28, 2018), https://www.nytimes.com/2018/02/28/opinion/corporate-america-activism.html.
89. Letter from Sens. Tom Cotton, Charles Grassley, Marco Rubio, Michael Lee & Marsha Blackburn to Kenneth Rivlin, Allen & Overy (Nov. 3, 2022), https://fingfx.thomsonreuters.com/gfx/legaldocs/znvnbdgxnvl/ESG%20letters%20to%20law%20firms.pdf.
90. Letter from John M. Schroder, State Treasurer, La., to Douglas L. Peterson, President & CEO, S&P Glob. Ratings, and Martina L. Cheung, President, S&P Glob. Ratings (May 19, 2022), https://882bef3f-7c0c-4c5b-bd78-db4eb1a05013.usrfiles.com/ugd/882bef_f7e963da1a0d4a25898854a-50f8805ea.pdf.

that impermissibly regulates interstate commerce and protects important constitutional values.

Article I Section 8 of the Constitution grants Congress the power to regulate interstate commerce.[91] This, along with the Supremacy Clause,[92] would give Congress the ability, by affirmatively legislating, to exclusively regulate all interstate commerce.[93] But the Commerce Clause leaves unresolved two important questions: "it does not say what the states may or may not do in the absence of congressional action, nor how to draw the line between what is and what is not commerce among the states."[94]

The Supreme Court's response to the first of those two "great silences,"[95] the absence of Congressional action, has been the slow and haphazard development of what has ultimately become the Dormant Commerce Clause doctrine.[96] The Court had to first determine whether the Commerce Clause's explicit grant of authority to Congress was exclusive—that is, whether states were absolutely prohibited from taking any action to regulate interstate commerce.[97] The Court ultimately concluded that it was not an exclusive grant.[98] If the Constitution did not completely prohibit state action impacting interstate commerce, the next question was whether there were any limits on such state action in the absence of Congressional action.[99] The plain text of the Commerce Clause provides virtually no guidance.[100] The Court in *Cooley* responded by adopting a rule that gave Congress exclusive authority over some subjects but not others:

> Now the power to regulate commerce embraces a vast field containing not only many but exceedingly various subjects quite unlike in their nature . . . .

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91. U.S. CONST. art. I, § 8.
92. U.S. CONST. art. VI, cl. 2.
93. *See* Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 236 (1824).
94. H. P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 534–35 (1949).
95. *Id.*
96. *See, e.g.*, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 87 (1987).
97. *Compare Gibbons*, 22 U.S. at 227 (holding the grant might be exclusive), *with* Thurlow v. Massachusetts (The License Cases), 46 U.S. 504, 585–86 (1847) (holding the grant was not exclusive as long as it does not conflict with congressional action).
98. *See* Cooley v. Board of Wardens, 53 U.S. 299, 319 (1851).
99. *See id.* at 319–20.
100. *See* U.S. CONST. art. I, § 8, cl. 3.

> Whatever subjects of this power are in their nature national, or admit only of one uniform system or plan of regulation, may justly be said to be of such a nature as to require exclusive legislation by Congress.[101]

The *Cooley* Court's rule was not based on the text of the Commerce Clause—instead, its national/local approach was rooted in practicalities: some issues require a uniform national rule, while other issues require diverse local rules to meet diverse local needs.[102] Other categorical approaches were considered,[103] but the Court ultimately adopted a balancing test.[104]

A. *The Rule*

The Supreme Court has developed a two-step test for determining whether a state law passes constitutional muster under the Dormant Commerce Clause.[105]

Step One is to determine if the law either (i) facially discriminates against interstate commerce or (ii) practically favors in-state over out-of-state interests.[106] The Supreme Court has adopted "virtually a *per se*" rule invalidating laws that fail Step One.[107] If a law survives the "strict scrutiny"[108] of Step One, Step Two is to determine "whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits."[109] This balancing test was articulated in *Pike v. Bruce Church, Inc.,* and requires a court to consider the legitimacy of the state's purpose, the nature of the local interest involved, and whether the state used the least impactful means to accomplish such purpose.[110]

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101. *Cooley*, 53 U.S. at 319.
102. *See id.*
103. *See id.*
104. S. Pac. Co. v. Arizona, 325 U.S. 761, 770–71 (1945).
105. *See* Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 578–79 (1986).
106. *See id.*
107. City of Philadelphia v. New Jersey, 437 U.S. 617, 623–24 (1978).
108 *See, e.g.*, Dep't of Revenue v. Nabors Int'l Fin., Inc., 514 P.3d 893, 905 (Ala. 2022) (describing the Supreme Court's first step analysis as "strict scrutiny").
109. *Brown-Forman Distillers Corp.*, 476 U.S. at 579.
110. 397 U.S. 137, 142 (1970).

Although it has been articulated as a two-step approach, the Supreme Court has been clear that "there is no clear line" separating the types of state action subject to *per se* invalidation from those subject to *Pike*'s balancing test, as both are measured by their impact to "both local and interstate activity."[111] The Court's most recent pronouncement on the Dormant Commerce Clause stated that both steps were intended to root out a "discriminatory purpose."[112]

B. *Dormant Commerce Clause Values*

The Dormant Commerce Clause doctrine has evolved as a way of balancing various competing constitutional concerns. In the *Pork* case, the Court rooted its full embrace of the anti-discrimination principle as a way of "mediat[ing] competing claims of sovereign authority under our horizontal separation of powers."[113] Formal considerations of course played a role in the creation and development of the Dormant Commerce Clause doctrine.[114] But because the Court continues to do values-based line-drawing—that is, using the guiding values that led to the creation of the Dormant Commerce Clause to create and justify rules of decision, rather than mere reference to the text of the Commerce Clause itself[115]—a discussion of the values animating the Dormant Commerce Clause is necessary.

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111. *Brown-Forman Distillers Corp.*, 476 U.S. at 579.

112. Nat'l Pork Producers Council v. Ross, 598 U.S. 356, 377 (2023). *See also Brown-Forman Distillers Corp.*, 476 U.S. at 579 ("In either situation the critical consideration is the overall effect of the statute on both local and interstate activity.").

113. *Nat'l Pork Producers Council*, 598 U.S. at 359, 376 ("To resolve disputes about the reach of one State's power, this Court has long consulted original and historical understandings of the Constitution's structure and the principles of 'sovereignty and comity' it embraces.").

114. *See* Barry Cushman, *Formalism and Realism in Commerce Clause Jurisprudence*, 67 U. CHI. L. REV. 1089, 1089–90 (2000).

115. *See, e.g.*, Comptroller of the Treasury of Md. v. Wynne, 575 U.S. 542, 551-56 (2015) (rejecting the dissents' and petitioner's formalistic distinction between corporations and individuals in part using the "reap what you sow" rationale); *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 298–300 (1997) ("Conceptually of course, any notion of discrimination assumes a comparison of substantially similar entities. Although this central assumption has more often than not itself remained dormant in this Court's opinions on state discrimination subject to review under the dormant Commerce Clause, when the allegedly competing entities provide different products, as here, there is a threshold question whether the companies are indeed similarly situated for constitutional purposes. This is so for the simple reason that the difference

One of the primary reasons for abandoning the Articles of Confederation in favor of a new Constitution was to address the economic protectionism that occurred after the Revolutionary War.[116] States at the time frequently imposed duties, imposts, and tariffs that resulted in a nationwide web of commercial regulations that were "confusing and conflicting."[117] Perhaps more damning to the fragile union was that the states were frequently motivated "by jealousy and the hope to win trade away from a neighboring state than by principles of wise policy or foresight."[118] After numerous failed attempts at amending the Articles to address this problem,[119] support for an entirely new balance of power grew.[120]

Congress's impotence to regulate interstate commerce under the Articles of Confederation was used repeatedly as

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in products may mean that the different entities serve different markets, and would continue to do so even if the supposedly discriminatory burden were removed. *If in fact that should be the case, eliminating the tax or other regulatory differential would not serve the dormant Commerce Clause's fundamental objective of preserving a national market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors*." (emphasis added)).

116. *See* Guy v. Baltimore, 100 U.S. 434, 440 (1879) ("Over whatever other interests of the country . . . this government may diffuse its benefits and blessings, it will always be true, as matter of historical fact, that it had its immediate origin in the necessities of commerce; and for its immediate object, the relief of those necessities, by removing their causes, and by establishing a uniform and steady system."); Hughes v. Oklahoma, 441 U.S. 322, 325 (1979) ("[T]he Commerce Clause . . . reflected a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that, in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.").

117. Brannon P. Denning, *Confederation-Era Discrimination Against Interstate Commerce and the Legitimacy of the Dormant Commerce Clause Doctrine*, 94 Ky. L.J. 37, 51–52 (2005) (quoting Andrew C. McLaughlin, The Confederation and the Constitution, 1783–1789 86 (1905)). *See also Guy*, 100 U.S. at 440 (referring to "that 'oppressed and degraded state,' existing at the adoption of the present Constitution, when the helpless, inadequate Confederation was abandoned and a national government instituted").

118. Denning, *supra* note 117, at 52 (quoting Andrew C. McLaughlin, The Confederation and the Constitution, 1783–1789 86 (1905)).

119. *See generally* Denning, *supra* note 117, at 50–52.

120. *Id.* at 55.

evidence favoring the new Constitution and the Commerce Clause it contained. In the *Federalist Papers*, James Madison appealed to the states' experience with fractured commercial governance and the lack of national solidarity it engendered.[121] The good of the nation—"an enlarged and permanent interest"—could not compete with "the clamors of an impatient avidity for immediate and immoderate gain" that caused states to seek to aggrandize themselves to their neighboring states' detriment.[122] The new Constitution therefore explicitly granted to Congress that authority "[t]o regulate Commerce . . . among the several States . . . ."[123] The *Federalist Papers* defended the federal government's new commercial power by appealing to both the commercial strength of the states united[124] as well as the risk of war among the states if they were permitted to regulate trade "to secure exclusive benefits to their own citizens."[125]

The idea that the explicit grant of authority to Congress to regulate interstate commerce might limit the states' ability was first discussed by the Supreme Court in 1824 in *Gibbons v. Ogden*.[126] Reading the Constitution's grant to Congress of the ability to regulate commerce as an exclusive grant would

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121. THE FEDERALIST NO. 42 (James Madison) ("We may be assured by past experience, that such a practice would be introduced by future contrivances; and both by that and a common knowledge of human affairs, that it would nourish unceasing animosities, and not improbably terminate in serious interruptions of the public tranquility."). *See also id.* ("The defect of power in the existing Confederacy to regulate the commerce between its several members, is in the number of those which have been clearly pointed out by experience.").

122. *Id.*

123. U.S. CONST. art. I, § 8.

124. THE FEDERALIST NO. 11 (Alexander Hamilton) ("[T]he aggregate balance of the commerce of the United States would bid fair to be much more favorable than that of the thirteen States without union or with partial unions").

125. THE FEDERALIST NO. 7 (Alexander Hamilton) ("The infractions of these regulations, on one side, the efforts to prevent and repel them, on the other, would naturally lead to outrages, and these to reprisals and wars.").

126. 22 U.S. (9 Wheat.) 1, 203, 209 (1824) (although decided under the Supremacy Clause, Justice Marshall found "great force" in the argument that the use of the word "regulate" "implies in its nature, full power over the thing to be regulated" and "excludes, necessarily, the action of all others that would perform the same operation on the same thing. That regulation is designed for the entire result, applying to those parts which remain as they were, as well as to those which are altered. It produces a uniform whole, which is as much disturbed and deranged by changing what the regulating power designs to leave untouched, as that on which it has operated.").

"produce[] a uniform whole," which echoes the language used by the Founders in seeking to create a uniform nation.[127] If the Commerce Clause was intended to give Congress the power to pursue a more unified nation, the *Dormant* Commerce Clause was recognized to stop states from getting in the way.

Although the Dormant Commerce Clause is "one of the oldest continuously applied doctrines in American constitutional law,"[128] the Supreme Court continues to wrestle with how best to balance the important competing interests involved when a state action is challenged as violative of the Dormant Commerce Clause.[129] The first case to invalidate a state law under the Dormant Commerce Clause was *Guy v. City of Baltimore*.[130] Baltimore charged wharfage dues on potatoes grown outside of Maryland, but not on potatoes grown inside the state.[131] After surveying previous decisions where a state law was invalidated on other constitutional grounds, the Court concluded "as settled that no State can, consistently with the Federal Constitution, impose upon the products of other States . . . more onerous public burdens or taxes than it imposes upon the like products of its own territory."[132] To permit such state laws would risk Congress's ability to meaningfully regulate interstate commerce and the "equality of commercial privileges" each U.S. citizen enjoys under the Constitution.[133] The Court therefore invalidated a municipal law that imposed fees only on potatoes grown outside of Maryland as explicitly "in conflict with the

127. *Id.* at 209, 225.
128. Denning, *supra* note 117, at 39.
129. *Compare* Nat'l Pork Producers Council v. Ross, 598 U.S. 356, 380–83 (2023) (rejecting the idea that courts are capable of balancing economic and noneconomic interests"), *with id.*, at 391–93 (Sotomayor, J., concurring in part) ("I acknowledge that the inquiry [balancing economic burdens against noneconomic benefits] is difficult and delicate, and federal courts are well advised to approach the matter with caution. Yet, I agree with THE CHIEF JUSTICE that courts generally are able to weigh disparate burdens and benefits against each other, and that they are called on to do so in other areas of the law with some frequency." (citations omitted), *and id.* at 396–97 (Roberts, C.J., concurring in part) ("I certainly appreciate the concern, but sometimes there is no avoiding the need to weigh seemingly incommensurable values." (citations omitted)).
130. 100 U.S. 434 (1879).
131. *Id.* at 440–41.
132. *Id.* at 437–39.
133. *Id.* at 439–40.

power of Congress over the subject of commerce."[134] The Court conceded that a state's police power would permit it to exclude goods that the state determined were deleterious to the public's health or safety.[135] But a law passed "under the guise of exerting [the state's] police powers" could still be invalid if that exercise was inconsistent with Congress's commerce powers.[136]

Since that early conception of the Dormant Commerce Clause, court decisions have been guided by several important constitutional values, including avoiding the evils of economic balkanization, preserving national unity, and protecting free trade in a national market.

1. *Preventing Economic Balkanization*

The Dormant Commerce Clause was conceived to stop state economic regulation from balkanizing the country. Early colonial and state governments showed a propensity for treating themselves and their own industries to favorable treatment.[137] States exercised their regulatory authority to favor in-state interests over out-of-state competitors.[138] Preventing this economic isolation was a driving force behind the creation of the Commerce Clause.[139]

To facilitate the Commerce Clause's "basic purpose," courts have been "alert[] to the evils of 'economic isolation' and protectionism . . . ."[140] Explicit protectionism is not required to trigger the Dormant Commerce Clause because "the evil of protectionism can reside in legislative means as well as legislative ends."[141] Thus, the Court in *City of Philadelphia v. New Jersey* invalidated a New Jersey law prohibiting neighboring states

134. *Id.* at 443–44 ("Nothing can be clearer than that the statute of Maryland and the ordinance of the city of Baltimore, in the respects adverted to, are in conflict with the power of Congress over the subject of commerce.").

135. *Id.* at 443.

136. *Id.*

137. *See* Dep't of Revenue of Ky. v. Davis, 553 U.S. 328, 337–38 (2008).

138. *Id.* (citing New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 273–74 (1988)).

139. *Id.*

140. City of Philadelphia v. New Jersey, 437 U.S. 617, 623 (1978).

141. *Id.* at 626. *See also* Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1951) ("A different view, that the ordinance is valid simply because it professes to be a health measure, would mean that the Commerce Clause of itself imposes no limitations on state action other than those laid down by the Due Process Clause, save for the rare instance where a state artlessly discloses an avowed purpose to discriminate against interstate goods.").

from importing their solid waste into New Jersey landfills that were rapidly reaching capacity.[142] The state court concluded that because New Jersey intended to protect the environment rather than the state's economy, the law passed muster.[143] The Supreme Court reversed because even if the state was pursuing a legitimate end, it could not do so by "illegitimate means of isolating the State from the national economy."[144] The Dormant Commerce Clause protects the states "from efforts by one State to isolate itself in the stream of interstate commerce from a problem shared by all."[145]

2. *Preserving National Unity*

The ultimate evil of balkanization was the tendency it had toward sowing disunion among the states. The Founders did not protect interstate commerce for interstate commerce's sake, but because of the tendency commerce had toward uniting the various states.[146] Indeed, the downfall of the Articles was not just that it restricted the nation's ability as a whole to prosper commercially, but that it "nourish[ed] unceasing animosities, and not improbably [would] terminate in serious interruptions of the public tranquility."[147] This was so because "[p]rotectionist trade laws and policies" passed by one state "invite prompt retaliatory response" by others.[148] This tit-for-tat dynamic among the states prior to the adoption of the Constitution led to very few productive economic agreements at great cost.[149] The threat to national unity was urgent and the driving force behind the Convention.[150]

Competition among states, including economic competition, was an important part of the new federal structure. The Supreme Court has used the Dormant Commerce Clause to set the rules of fair play among the states.[151] The Court

142. 437 U.S. at 628–29.
143. *Id.* at 625.
144. *Id.* at 626–27.
145. *Id.* at 629.
146. *See* THE FEDERALIST NO. 42 (James Madison).
147. *Id.*
148. Dep't of Revenue of Ky. v. Davis, 553 U.S. 328, 363 (2008) (Kennedy, J., dissenting).
149. *Id.* at 363–64.
150. *Id.*
151. *See* Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 505 U.S. 71, 79 (1992) ("[A] state's preference for domestic commerce over foreign

appears particularly worried when a state passes a law targeted at another specific state. Washington State maintained its own grading system for apples, which thanks in part to a decades-long investment by the state government, had become a nationally accepted grading system.[152] In a bid to promote apples produced locally, North Carolina passed a law banning the use of any other state's grading system for apples.[153] Its ostensible reason for the ban was to eliminate consumer deception, although the Court found that justification to be pretextual.[154] The Court found that the law violated the Dormant Commerce Clause because it raised the costs for Washington producers but not in-state producers; stripped Washington producers of their competitive edge gained "through its expensive inspection and grading system;" and had a "leveling effect which insidiously operates to the advantage of local apple producers."[155]

3. *Promoting Free Trade*

Citizens were meant to enjoy the benefits of an integrated, national market; "[t]he creation of a national free market is widely accepted as a major purpose of the commerce clause."[156] Indeed, the creation of a single, unified economy compelled the creation of the Dormant Commerce Clause doctrine:

> This principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control of the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units. . . . [W]hat is ultimate is the principle that one state in its dealings with another may not place itself in a position of economic isolation.[157]

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commerce is inconsistent with the Commerce Clause even if the State's own economy is not a direct beneficiary of the discrimination.").

152. Hunt v. Wash. State Apple Advert. Comm'n, 432 U.S. 333, 351 (1977).

153. *Id.* at 337–39. North Carolina did not have a grading system. Instead, the law required all apples sold to use the USDA labels or nothing at all. *Id.* at 337.

154. *Id.* at 349, 352.

155. *Id.* at 351.

156. Dan T. Coenen, *Untangling the Market-Participant Exemption to the Dormant Commerce Clause*, 88 MICH. L. REV. 395, 431 (1989).

157. City of Philadelphia v. New Jersey, 437 U.S. 617, 623 (1978) (citation omitted).

The importance of this national market has grown as the nation has grown more technologically and economically interdependent.[158] The unified national market is important enough to override state action even when a state is regulating to protect legitimate government interests, such as consumer confusion over food quality.[159]

The Dormant Commerce Clause restrictions have been judicially created to give animus to these important constitutional principles. The doctrine is an important mechanism by which the Court continues to promote and protect the prosperity and peace of the nation as a whole. Competing principles have led to the creation of another doctrine—the Market Participant Exception.

III.
The Market Participant Exception

If determining whether a state law violates the Dormant Commerce Clause doctrine is a two-part test, then Step Zero is determining whether the state action is subject to Dormant Commerce Clause scrutiny at all.[160] When a state participates in a market—such as when it buys or sells goods—rather than regulating it, the Supreme Court has declared that the Dormant Commerce Clause restrictions do not apply.[161] It is not that the state's status as market participant gives it a leg up in the strict scrutiny or *Pike* balancing analysis; it is that no Dormant Commerce Clause analysis applies at all.[162] This is so because when the state is acting as a market participant, its activities do not

158. *See* Dep't of Revenue of Ky. v. Davis, 553 U.S. 328, 362 (2008) (Kennedy, J., dissenting).

159. *See Hunt*, 432 U.S. at 350.

160. Whether the Market Participant Exception applies is a "threshold question" before the Dormant Commerce Clause analysis. Tri-M Grp., LLC v. Sharp, 638 F.3d 406, 415 (3d Cir. 2011).
Therefore, "when a state or local government enters the market as a participant, it is not subject to the restraints of the Commerce Clause," and our "single inquiry" is limited to ascertaining "whether the challenged 'program constituted direct state participation in the market.'" White v. Mass. Council of Constr. Emps., Inc., 460 U.S. 204, 208 (1983) (quoting Reeves, Inc. v. Stake, 447 U.S. 429, 435 n.7 (1980)); Reeves, Inc. v. Stake, 447 U.S. 429, 419 n.7 (1980).

161. *Davis*, 553 U.S. at 339.

162. *Id.* at 353.

constitute regulation of interstate commerce in violation of the Commerce Clause.[163]

A. *Market Participant Exception Values*

Just as the Court's Dormant Commerce Clause doctrine is heavily informed by values,[164] so too is the Court's market participant doctrine. The Market Participant Exception is trying to satisfy these values: protect states' sovereignty, allow states to pursue and protect their economic interests, build local economies, and encourage competition among the states.

1. *State Sovereignty*

The primary value posited in favor of the Market Participant Exception is the protection of state's sovereign autonomy, including the "freedom to decide how, with whom, and for whose benefit to deal."[165] A state's ability to choose its own trading partners stems from the state's status as both sovereign and proprietor.

In their sovereign capacity, states retain at least "some measure of a sovereign interest in retaining freedom to decide how, with whom, and for whose benefit to deal."[166] This permits the state to effectuate its role as the "guardian and trustee

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163. *See White*, 460 U.S. at 206–08 (discussing *Reeves* and Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976)).

164. There are, of course, formal considerations here too.

> The basic distinction drawn in *Alexandria Scrap* between States as market participants and States as market regulators makes good sense and sound law. As that case explains, the Commerce Clause responds principally to state taxes and regulatory measures impeding free private trade in the national marketplace. [*Alexandria Scrap Corp.*, 426 U.S.] at 807–808, citing H. P. Hood & Sons v. Du Mond, 336 U.S. 525, 539 (1949) (referring to "home embargoes," "customs duties," and "'regulations" excluding imports). There is no indication of a constitutional plan to limit the ability of the States themselves to operate freely in the free market. *See* L. Tribe, American Constitutional Law 336 (1978) ("the commerce clause was directed, as an historical matter, only at regulatory and taxing actions taken by states in their sovereign capacity"). The precedents comport with this distinction.

Reeves, 447 U.S. at 436–37.

165. *Id.* at 438 n.10.

166. *Id.*

for its people."[167] Subjecting state proprietary action to judicial scrutiny may be "a greater intrusion on state autonomy . . . than to cabin [the state's] otherwise limitless power to coerce through government fiat."[168] Doing so would disincentivize states from using creative solutions to solve uniquely local problems.[169]

Setting aside any special autonomy a state has as sovereign, when the state is acting as a proprietor, it should have the same freedom that other proprietors enjoy. A private party is "free[] to exercise his own independent discretion as to parties with whom he will deal" free of the Dormant Commerce Clause scrutiny.[170] When a state is a party to a business transaction, it should be no worse off than a private party would be in a similar transaction.[171] Of course, a private party does not have unfettered discretion to choose with whom and on what terms it will contract, and when a state is wearing its proprietor hat, it is subject to many of the same restrictions.[172] Therefore, a state cannot discriminate based on race or national origin.[173]

Professor Dan Coenen, in his article *Untangling the Market-Participant Exemption to the Dormant Commerce Clause*, provided a thorough defense of this state-as-trader rationale supporting the Market Participant Exception, primarily because "discriminatory actions by states in the marketplace pose *less* of a risk than discriminatory regulations and taxes to the values underlying the dormant commerce clause."[174] This rationale is consistent with the values underlying the Dormant Commerce Clause and Market Participant Exception because (i) states, like private traders, may make decisions based on factors other

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167. *Id.* at 438 (quoting Heim v. McCall, 239 U.S. 175, 191 (1915)).

168. Coenen, *supra* note 156, at 427.

169. *Id.* at 428.

170. *Id.* at 430 (citing Reeves, Inc. v. Stake, 447 U.S. 429, 438–39 (1980) (quoting United States v. Colgate & Co., 250 U.S. 300, 307 (1919))).

171. *See Reeves*, 447 U.S. at 439 ("Evenhandedness suggests that, when acting as proprietors, States should similarly share existing freedoms from federal constraints, including the inherent limits of the Commerce Clause."); *see also* Trojan Techs., Inc. v. Pennsylvania, 916 F.2d 903, 911 (3d Cir. 1990) ("[T]he Commonwealth enjoys the same right to specify to its suppliers the source of steel to be used in any supplies provided as is enjoyed by similarly situated private purchasers.").

172. *See Reeves*, 447 U.S. at 439.

173. *See* Adarand Constructors, Inc. v. Pena, 515 U.S. 200 (1995) (holding that the employment of racial classification practices by governmental actors when deciding who to award contracts to is subject to strict scrutiny).

174. Coenen, *supra* note 156, at 432.

than economic efficiency;[175] (ii) in-state preferences in state contracts are so uncontroversial that they are unlikely to provoke resentment amongst states;[176] and (iii) the expensiveness of market participation will "brake the danger to commerce clause concerns."[177] Professor Coenen also provided formal and institutional considerations that provide ample reason for courts to be cautious when dealing with states-as-traders.[178]

The Market Participant Exception, then, protects the state's important and historic interest in choosing with whom it does business, while limiting the risk to other important Dormant Commerce Clause values. However, the rationale protecting the state-as-trader weakens the further away from the "immediate transaction" you move.[179] Thus, although a state could choose to whom it would sell timber, it could not control to whom the purchased timber was subsequently sold.[180] Limiting the scope of the Market Participant Exception avoids "the doctrine . . . swallowing up the rule that States may not impose substantial burdens on interstate commerce even if they act with the permissible state purpose of fostering local industry."[181]

2. *States' Economic Interests*

As economic actors, states should be allowed to protect their own proprietary economic interests, respond to specific local needs,[182] and act in a way the state deems fit in view of its limited resources.[183] These interests include the money being spent or received as part of a transaction as well as other assets

175. *See id.* at 432–33.
176. *See id.* at 433–34.
177. *Id.* at 434–35.
178. *Id.* at 435, 438.
179. S.–Cent. Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 98 (1984) ("[S]imply as a matter of intuition a state market participant has a greater interest as a "private trader" in the immediate transaction than it has in what its purchaser does with the goods after the State no longer has an interest in them.").
180. *Id.*
181. *Id.*
182. *See* Tri-M Grp., LLC v. Sharp, 638 F.3d 406, 425 (3d Cir. 2011) ("As in *Dillingham,* Delaware's permanent place of business requirement was not enacted for purposes of a specific project or to service unique needs.").
183. *See id.* ("Here, the 'legislative purpose is not the efficient procurement of goods and services, but the furtherance of a labor policy,' namely, the setting of standards for training and payment of apprentices in public and private contracts alike." (citing Chamber of Com. of the U.S. v. Brown, 554 U.S. 60, 70 (2008)).

in which the state has proprietary interests. These interests largely align with proprietary interests of private traders in similar situations.[184]

When a state buys goods or services, it should be able to contract around risks associated with its purchases and ensure it receives the benefit of the bargain it is striking. The Market Participant Exception serves this important state interest by exempting from Dormant Commerce Clause scrutiny contracts terms that are "specifically tailored to protect [the state's] proprietary interest in the value of the implicated property"[185] and that are "specifically tailored to one particular job."[186]

The Market Participant Exception also responds to the fact that state resources are limited, and when a state chooses to spend from its largesse, it is permitted to bargain for the best deal terms. Just as any other economic actor, states must choose when and how to spend their limited resources to accomplish the various activities necessary to carry out their purposes.[187] On a deal-by-deal basis, the Market Participant Exception permits states to maximize the value of the deal. This also lets states set procurement policies and conditions that respond to local needs.[188]

3. *Building Local Economies and Fostering Competition*

The Market Participant Exception permits states to buy and sell in a way that promotes economic growth within their borders. "Fostering local industry" is a legitimate government interest.[189] The state's ability to support economic growth within its borders is powerfully supported by the reap-what-you-sow doctrine.[190] This value is a counterbalance to the Commerce Clause's primary purpose of preventing economic protectionism.

The ability to build local economies is in some tension with the corresponding value of competition between states. In our horizontal federalism, states should be permitted to compete

184. Reeves, Inc. v. Stake, 447 U.S. 429, 438 n.10 (1980).
185. Tri-M Grp., 638 F.3d at 421–22 (quotations and citations omitted).
186. *Id.* at 422 (quoting Brown, 554 U.S. at 70).
187. See id.
188. See Matrix Dev. Grp. v. City of Newark, No. 20-3166, 2021 WL 3260854, at *15 (D.N.J. July 30, 2021).
189. S.–Cent. Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 98 (1984).
190. See Coenen, supra note 156, at 421–26.

with one another and experiment with novel arrangements. Although the Commerce Clause was adopted with the aim of curbing rampant discrimination by states, state experimentation was an important part of the context in which the clause was passed: "the pro-national values of the commerce clause do not stand alone. The Framers' endorsement of a system of federalism envisioned experimentation—including economic experimentation—in individual states."[191] This experimentation allows states to "fashion[] effective and creative programs for solving local problems and distributing government largesse."[192]

Experimentation by states is not limited to carrying out traditional government functions.[193] States may also experiment with economic programs, particularly when the state is itself "trading on its own account."[194] Professor Coenen argues that this Market Participant Exception value—state experimentation—may actually promote the Commerce Clause value of national unity: "More subtly, the allowance of substantial local control may promote the healthiest brand of nationalism by fostering pursuit of different traditions in a spirit of shared toleration."[195]

These values—protecting state autonomy and economic interests and encouraging local control and experimentation—have guided courts as they have sought to define the boundary between unfettered market participation and impermissible market regulation.

B. *Market Participant Exception Rules*

Whether a state is *participating* in rather than *regulating* a market is a sensitive inquiry for which no bright-line test exist. The form of state action—statute, regulation, or contract provision—is not dispositive.[196] Although the archetype of market

191. *Id.* at 418.
192. *Id.* at 428 (citing Reeves, Inc. v. Stake, 447 U.S. 429, 441 (1980)).
193. *See id.* at 408.
194. *See id.* at 482–83.
195. *Id.* at 427.
196. *See* S.–Cent. Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 93–95 (1984) (explaining that "[t]he precise contours of the market-participant doctrine have yet to be established . . . ." along with the considerations prior Courts have taken to determine whether governmental actors are acting as a participant or a regulator, which do not include the form of state action).

participation is the state contracting to purchase goods or services for itself, a contract provision in a commercial agreement to which the state is a party may be considered regulatory.[197] Conversely, although legislation may appear to be inherently regulatory, the activities that are the subject of the legislation may be deemed to constitute market participation.[198]

The Supreme Court has never articulated a clear, generally applicable rule for characterizing participation versus regulation. However, the Court's analysis shows the balancing of values that is inherent at the confluence of the Dormant Commerce Clause and Market Participant Exception.[199] The Supreme Court's most recent decision to squarely address the Market Participant Exception to the Dormant Commerce Clause was in 2008. Kentucky's tax exemption for local bonds was challenged under the Dormant Commerce Clause.[200] The Court dismissed the challenge, concluding that Kentucky's regime did not trigger Dormant Commerce Clause scrutiny because it did not discriminate against interstate commerce.[201] Alternatively, the Court found that by issuing bonds, Kentucky had entered the market for "limited investment dollars, alongside private bond issuers and its sister States . . . ."[202] When paired with this market participation, Kentucky's favorable tax treatment was considered simply "one of the tools of competition" rather than impermissible discrimination against interstate commerce. [203]

The Court's discussion in *Davis* highlights the balancing of constitutional values that is inherent in the Market Participant Exception and the underlying Dormant Commerce Clause. For example, it was important to the Court that the taxation scheme was in support of the "traditional government function"[204] of raising revenue for public projects in furtherance of

197. *Compare id.* at 84–85 (holding that the contract provision requiring in-state processing of timber was not protected by the Market Participant Exception), *with* BFI Waste Sys. of N. Am., Inc. v. Broward County, 265 F. Supp. 2d 1332, 1343 (S.D. Fla. 2003) (holding that the challenged contract clause was "exempt from Commerce Clause scrutiny" under the Market Participant Exception).

198. *See* Nat'l Pork Producers Council v. Ross, 598 U.S. 356 (2023).

199. *See, e.g.*, Dep't of Revenue of Ky. v. Davis, 553 U.S. 328 (2008).

200. *Id.* at 331.

201. *Id.* at 341–42.

202. *Id.* at 345.

203. *Id.*

204. *Id.* at 343.

the "cardinal civic responsibilities" borne by the states.[205] Regulations coupled with market participation were imbued with "a civic objective different from the discrimination traditionally held to be unlawful."[206]

With regard to the bond market specifically, there was little risk of balkanization or the national unity being threatened. The tax scheme had been employed for more than a hundred years by numerous states without the adverse consequences the Dormant Commerce Clause was meant to guard against.[207] Moreover, the vast majority of states currently employed a similar scheme, and all but one state had submitted their affirmative support for Kentucky in the litigation.[208] With such widespread support amongst the states, Kentucky's regime would not engender the sort of jealousy that other, more discriminatory means may have: "These facts suggest that no State perceives any local advantage or disadvantage beyond the permissible ones open to a government and to those who deal with it when the government itself enters the [bond] market."[209]

The Market Participant Exception created in the Dormant Commerce Clause context was later extended by the Supreme Court to preemption.[210] State regulation is preempted if it can be determined that Congress intended to occupy the entire space.[211] But only state *regulation* is preempted; a state's market participation is not.[212]

Although the Supreme Court has not established a functional test for categorizing participation versus regulation, circuit courts have developed a number of tests to determine whether state action is participation or regulation in the Dormant Commerce Clause or preemption context. The Third Circuit uses a two-part test[213]: "First, does the challenged funding condition serve to advance or preserve the state's proprietary interest in a project or transaction, as an investor, owner, or

205. *Id.*
206. *Id.* at 347.
207. *Id.* at 341–42.
208. *Id.* at 342.
209. *Id.* at 350.
210. *See* Nw. Cent. Pipeline Corp. v. State Corp. Comm'n of Kan., 489 U.S. 493 (1989).
211. *Id.* at 509.
212. *See id.*
213. At least it does in a financing context. *See* Hotel Emps. & Rest. Emps. Union, Loc. 57 v. Sage Hosp. Res., LLC, 390 F.3d 206 (3d Cir. 2004).

financier? Second, is the scope of the funding condition 'specifically tailored' to the proprietary interest?"[214]

The Fifth Circuit adopted a similar two-part test in *Cardinal Towing*:

> First, does the challenged action essentially reflect the entity's own interest in its efficient procurement of needed goods and services, as measured by comparison with the typical behavior of private parties in similar circumstances? Second, does the narrow scope of the challenged action defeat an inference that its primary goal was to encourage a general policy rather than address a specific proprietary problem?[215]

The test was articulated in the context of a preemption challenge to the City of Bedford's non-consensual towing scheme. A company that lost the bid for the exclusive towing contract with the city sued, arguing that the City's new scheme was preempted by a federal statute.[216] The Court concluded both prongs of the test above were satisfied and the city's action was, therefore, proprietary and not subject to preemption.[217]

The purpose of the two-part test was to rule out "a regulatory impulse" in the challenged government action.[218] It was important to the court that the government "acted as a typical private party would act in seeking" the service in question, and that the government's action was consistent "with the ordinary behavior of private parties."[219] Moreover, the government action was "obviously related" to a "narrow proprietary interest."[220] The contract requirements dealt with "the type of administrative and legal issues that would be of interest to a private entity."[221] The Court could detect no intent by the city to influence or

214. *Id.* at 215–16 (citing Bldg. & Constr. Trades Council v. Assoc. Builders & Contr. of Mass./R.I., Inc., 507 U.S. 218, 232 (1993)); Tri-M Grp., LLC v. Sharp, 638 F.3d 406, 421 (3d Cir. 2011).

215. Cardinal Towing & Auto Repair, Inc. v. City of Bedford, 180 F.3d 686, 693 (5th Cir. 1999).

216. *Id.* at 688–89 (citing 49 U.S.C. § 14501(c)).

217. *Id.* at 693–95.

218. *Id.* at 693.

219. *Id.*

220. *Id.*

221. *Id.*

control behavior other than what was directly connected to the contract in question.[222]

The scope of the city's new towing scheme was also consistent with a proprietary action rather than a regulatory one. The provisions did not regulate the behavior of anyone in the market other than the winning bidder.[223] And the provisions governed only the behavior of the winning bidder related to the contract—the winning bidder was free to deal with its other customers as it saw fit.[224] The specifications applied only to the challenged contract and not all future contracts with the government.[225] There was, therefore, no evidence that the challenged government action was intended to influence a specific market, "let alone influence society at large."[226]

The Ninth Circuit has adopted the Fifth Circuit's approach in *Cardinal Towing*.[227] *Johnson* was also a preemption case. The Ninth Circuit said that the first prong of the *Cardinal Towing*—which "looks to the nature of the expenditure"[228]—was not triggered simply because the state could have gotten a better deal.[229] At least in the preemption context, congressional intent to preempt state action is the key, not whether the state made a prudent decision.[230]

The Court also clarified that the state's interest in "efficient procurement" does not require the state to make decisions based only on the lowest cost provider; the state could consider other interests and still be acting in its proprietary capacity.[231] In the context of setting rules "governing purchasing, procuring, leasing, and contracting for the use of vehicles by state and

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222. *Id.*

223. *Id.* at 694 ("Unlike the attempts of other municipalities to deal with tow truck issues, the City here limited itself only to true nonconsent tows where the owner of the vehicle was unwilling or unable to specify a towing company.").

224 *Id.* ("[T]he specifications here looked only to the bidder's dealings with the City. Cardinal's failure to guarantee its other customers access to a large wrecker or service within fifteen minutes would have had no impact on its bid if the City had been satisfied it would receive such service.").

225. *Id.*

226. *Id.*

227. Johnson v. Rancho Santiago Cmty. Coll. Dist., 623 F.3d 1011 (9th Cir. 2010).

228. Chamber of Com. of the U.S. v. Lockyer, 463 F.3d 1076, 1084 (9th Cir. 2006) (en banc).

229. *Johnson*, 623 F.3d at 1025.

230. *Id.*

231. *Id.* at 1025.

local governmental entities," for example, the fact that the government pursued the environmental goal of lowering emissions did not change the proprietary character of the state action.[232]

The pursuit of some state interests, however, will move the state action into the regulatory realm. A state scheme that prohibited agencies from doing business with "labor law violators" was held to be regulatory rather than proprietary.[233] The Supreme Court established that "where a state seeks to affect private parties' conduct unrelated to the performance of contractual obligations to the state, the state's direct participation in the market does not reflect its interest in 'efficient procurement' of goods and services."[234] Wisconsin maintained a list of firms that had violated the NLRA and prohibited state agencies from signing contracts with those firms.[235] One of the barred firms challenged the law, arguing that it was preempted under the NLRA.[236] The state argued that the law was "an exercise of the State's spending power rather than its regulatory power," and was therefore not preempted.[237] The Supreme Court disagreed. The state law was clearly intended as a disincentive to violating the NLRA, and to allow the state to impose a penalty that exceeded the federal regime was regulatory in nature, notwithstanding the character of the state action was to limit the state's spending only.[238]

The Court's Market Participant Exception analysis was a practical one. The scope of the law—which provided for a blanket prohibition on state agencies from doing business with NLRA violators—was regulatory "for all practical purposes."[239] This was so even though a private party could have chosen to adopt the same policy of refusing to do business with a repeat violator.[240] Even though the Market Participant Exception asks

232. Engine Mfrs. Ass'n. v. S. Coast Air Quality Maint. Dist., 498 F.3d 1031, 1045 (9th Cir. 2007).

233. Wis. Dep't of Indus., Lab. and Hum. Rels. v. Gould Inc., 475 U.S. 282, 289 (1986).

234. *Johnson*, 623 F.3d at 1025–26 (9th Cir. 2010).

235. *Gould*, 475 U.S. at 283–84.

236. *Id.* at 285.

237. *Id.* at 287.

238. *Id.* at 287–89 ("It is the conduct being regulated, not the formal description of governing legal standards, that is the proper focus of concern." (citing Motor Coach Emps. v. Lockridge, 403 U.S. 274, 287 (1971)).

239. *Id.* at 289.

240. *Id.* at 290.

whether a state is behaving like a private party could,[241] states are importantly *not* like private parties and therefore are "rightly subject to special restraints."[242] This recognizes that private parties and states have different roles to play.[243]

Even in the preemption context, state spending decisions may be justified under the Market Participant Exception when the state is making decisions based on state interests that are "deeply rooted in local feeling and responsibility" or that are "a legitimate response to state procurement constraints or to local economic needs."[244] But state action that falls outside of those kinds of permissible state motives does not enjoy the benefit of the Market Participant Exception.

Private parties can also act with regulatory purpose. Thus, a private party can boycott a supplier even if there is no profit motive.[245] A private firm acting with such a motive is not acting like a typical proprietor.[246] A state would not therefore automatically qualify as a market participant if it took the same action for the same reason, even though it was acting like a private party *could*.[247] Of course, private action is not subject to preemption like state action is, which recognizes that the state has "a qualitatively different role to play from private parties."[248] So the state may not simply find a private party that took a similar action in order to enjoy the benefits of the market participant exception.

Instead, the state must show that its challenged action was an attempt to accomplish a permissible, proprietary goal in a way that was specifically tailored to the particular job, motivated by legitimate interests.[249] When the state acts like a private party *would*, and is motivated purely by legitimate, proprietary interests, the state action is immune from preemption.[250]

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241. *But see id.* at 289–90.
242. *Id.* at 290.
243. *Id.*
244. *Id.* at 290–91.
245. *See* Bldg. & Constr. Trades Council v. Assoc. Builders & Contractors of Mass./R.I., Inc., 507 U.S. 218, 229 (1993).
246. *Id.*
247. *Id.*
248. *Id.*
249. *Id.* at 232–33.
250. *Id.*

The Sixth Circuit clarified in *Allied Construction Industries v. Cincinnati* that although state action should be tailored to a specific project, states may still pass laws of general applicability and still be acting as a proprietor. Cincinnati passed an ordinance establishing criteria for determining who the "lowest and best bidder" was on certain public projects.[251] The law on its face served quintessential proprietary functions of "ensur[ing] efficient use of taxpayer dollars" and "minimiz[ing] waste."[252] The law was also intended to promote fair treatment of workers.[253] Non-union bidders challenged as preempted the provisions requiring bidders to disclose whether they provided their employees with a health care plan[254] and retirement plan.[255] The court explicitly decided that the Market-Participant Doctrine applies to ERISA preemption.[256] The court then joined the Ninth Circuit in applying the Fifth Circuit's two-part test in *Cardinal Towing* disjunctively.[257]

In applying the first part of the *Cardinal Towing* test—asking whether the state action furthers the state's interest in efficient procurement as compared to typical private party behavior—the Court allowed states to consider more than simply who is the "cheapest possible bidder."[258] Importantly, Cincinnati did not defend its ordinance requirements by simply repeating the axiom that if a private party can, then a municipality can too. Instead, the city provided evidence that private parties also considered contractor healthcare, retirement plan, and apprentice program information in selecting partners.[259] There was evidence that private parties in similar circumstances

251. Allied Constr. Indus. v. Cincinnati, 879 F.3d 215 (6th Cir. 2018).

252. *Id.* at 217. For example, the ordinance required bidders to certify they had all required licenses and that they would not subcontract more than 75% of the project. CINCINNATI, OHIO, CODE OF ORDINANCES tit. III, § 320-3(i) (2013).

253. *Allied Constr. Indus.*, 879 F.3d at 217. The law required bidders to disclose whether workers had received OSHA training, provided a drug-free workplace, and any previous violations of wage laws.

254. *Id.* at 218; CINCINNATI, OHIO, CODE OF ORDINANCES tit. III, § 320-3(j) (2013).

255. *Allied Constr. Indus.*, 879 F.3d at 218; CINCINNATI, OHIO, CODE OF ORDINANCES tit. III, § 320-3(k) (2013).

256. *Allied Constr. Indus.*, 879 F.3d at 220.

257. *Id.* at 221.

258. *Id.*

259. *Id.* at 222

consider "quality, timeliness, safety and predictability" in addition to cost.[260] Based on that evidence, the court speculated that a city "might reasonably conclude" that bidders who provided benefits to their employees would experience less turnover.[261]

The Court's line-drawing in this case appears to be less about identifying where the line is between proprietary and regulatory action by a state, and more about drawing a connecting line between a core proprietary concern—"improving the stability and overall quality of a project"[262]—and the challenged state action. It reiterated this "connection" approach when it allowed the state's preference for bidders with apprenticeships because "the City's reasonable concern" over a possible shortfall of trained workers who would be available for city projects in the future" was connected to the city's "strong proprietary interest in developing a skilled workforce."[263] The Court was not bothered by the fact that the city's actions manifested a policy preference—in this case the law was accused of being pro-Union—as long as the city was acting on its own behalf.[264]

Of course, the idea that state action might be both regulatory and participatory—or that a state may combine regulatory actions with proprietary actions as part of a coordinated scheme—is not new. In *White*, for example, Boston's regulations governing private party hiring practices—"the essence of regulation"[265]—were treated as "terms or conditions of the government's efforts in its market role, which was treated as dispositive."[266] So where regulatory actions are subservient to the state's market participation, it appears the Court is willing to categorize the scheme as participation and treat that characterization as dispositive under the Dormant Commerce Clause.[267] The *Davis* Court said that in each of these hybrid regulatory-proprietary actions, the government's "foray into the market" gave the complementary regulations a "civic objective"

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260. *Id.*

261. *Id.* The Court's speculation was "consistent" with the city's own findings enshrined in law, but the logical conclusion appeared to be the court's own.

262. *Id.*

263. *Id.*

264. *Id.*

265. White v. Mass. Council of Constr. Emps., 460 U.S. 204, 219 (1983) (Blackmun, J., concurring in part and dissenting in part).

266. Dep't of Revenue of Ky. v. Davis, 553 U.S. 328, 346 (2008).

267. *See id.* at 345.

as opposed to a constitutionally suspect discriminatory one.[268] Importantly, each of the highlighted examples used by the Court in *Davis* involved state participation in specific markets—the purchase of construction labor in *White,*[269] automobile hulks in *Alexandria Scrap,*[270] and trash in *United Haulers.*[271] It was not simply that the government was spending money—the government was participating in a market for a purpose other than discrimination and the applicable regulations supported those purposes.

That the government's requirements might require some bidders to "alter their usual mode of operation to secure the business opportunity at hand"[272] did not mean the requirement was regulatory versus proprietary; those same bidders would be faced with the same potentiality in trying to win business from private parties with similar requirements.[273] The Court applied a reasonableness standard to the nexus required between a proprietary interest and the challenged state action: "as long as the state or municipality's bidding requirements can reasonably be said to reflect its interests in efficient procurement, as measured by comparison to the actions of private parties, the first step of *Cardinal Towing* is satisfied."[274] The *Cincinnati* court concluded the city was a market participant when it adopted the bidding requirements and preemption did not apply.[275]

Under the disjunctive approach to *Cardinal Towing*, the Court's conclusion under the first step meant the second step was not triggered. However, the Court continued to analyze step two "for the sake of clarifying [its] newly adopted framework."[276] Prior to engaging in its illustrative analysis, however, the court stated that satisfaction of the first step of *Cardinal Towing* meant the court "infer[red] that the Ordinance is primarily proprietary."[277] The concept of a "*primarily*

268. *See id.* at 347.
269. *White*, 460 U.S. at 204.
270. Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976).
271. United Haulers Ass'n v. Oneida–Herkimer Solid Waste Mgmt. Auth., 550 U.S. 330. (2007).
272. Allied Constr. Indus. v. City of Cincinnati, 879 F.3d 215, 223 (6th Cir. 2018).
273. *See id.* at 223.
274. *Id.*
275. *See id.* at 224.
276. *Id.* at 223.
277. *Id.*

proprietary" state action blurs the otherwise binary choice between proprietary and regulatory actions. That said, it is consistent with the phrasing of step two of *Cardinal Towing* which looks at the scope of the action to determine if the "primary goal" was regulatory rather than proprietary.[278] The choice set up by step two is between encouraging "a general policy" or addressing "a specific proprietary problem."[279] The nexus required in step two could be similar to the nexus required in step one—i.e., identify a specific proprietary problem and see how directly connected to that proprietary interest the state's solution is. Alternatively, the line-drawing required by step two could be thought of as classic boundary-drawing. Courts know what obvious proprietary action looks like, and they know what obvious regulatory action looks like. Step two asks, "Is this more like this or that?"

If having any legitimate interest was enough in the first part of the test, then the market participant test would swallow the rule because states can always articulate a reason their provision is good for the local economy. But a state's ability to demand contract provisions is not unlimited, such as in *White*.

Although both the Dormant Commerce Clause doctrine and Market Participant Exception to that doctrine find formal support in the text of the Constitution, both are functional doctrines intended to protect and animate important constitutional values, which at times compete and at times complement each other. The line between market regulation invalidated by the Dormant Commerce Clause and market participation protected by the Market Participant Exception may at first appear clear, like the confluence of a muddy and clear river. Closer inspection reveals not a bright line but "soft edges" between the two rivers, and indeed between market regulation and participation.[280]

When you're well clear of the dividing line, it can be easy to tell whether state action is regulation or participation.[281] However, the closer you get to those soft edges, the harder it

278. *See id.* at 220–21 (quoting Cardinal Towing & Auto Repair, Inc. v. City of Bedford, 180 F.3d 686, 693 (5th Cir. 1999)).

279. *See id.* at 220–21 (quoting Cardinal Towing & Auto Repair, Inc. v. City of Bedford, 180 F.3d 686, 693 (5th Cir. 1999)).

280. Am. Trucking Ass'ns v. City of Los Angeles, 133 S. Ct. 2096, 2103 (2013).

281. *See, e.g.*, *id.* at 2103 ("Contractual commitments resulting not from ordinary bargaining . . . but instead from the threat of criminal sanctions

can be to determine whether a particular state action is more like regulation that should be subject to Dormant Commerce Clause scrutiny or more like market participation that is immune.

Professor Coenen said courts should be guided by following considerations in determining whether a state program should qualify as market participation:

> To decide market-participant cases, then, courts must consider whether the challenged program does or does not bring into play the policies underlying the market-participant rule. In particular, they must consider:
>
> (1) whether the program reflects an effort of local citizens to reap where they have sown;
>
> (2) whether invalidation of the program is consonant with the underlying values of federalism, including in particular the values of local experimentation and optimal responsiveness to local concerns;
>
> (3) to what extent the program threatens the underlying commerce clause values of a free market and unified nation; and
>
> (4) whether the state bears the appearance of "participating in," rather than "regulating," the market.[282]

He also proposed a number of "discrete sub-inquires" to help make the application of these "soft factors" easier for courts.[283] Professor Coenen's analysis is rooted in the value-based line-drawing that the Court has used in fleshing out the contours of both the Dormant Commerce Clause and the Market Participant Exception doctrines. His history and framework have proven useful to courts—including the Supreme Court[284]—in navigating the "fuzzy" "line between state market participation and state regulation . . . ."[285] This Article

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manifest the government *qua* government, performing its prototypical regulatory role.").

282. Coenen, *supra* note 156, at 441.

283. *See id.* at 441–42.

284. *See, e.g.*, W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 211–12 (1994) (Scalia, J., concurring).

285. White v. Mass. Council of Constr. Emps., 460 U.S. 204 (1983) (Blackmun, J., concurring in part and dissenting in part).

builds on Professor Coenen's guidance in the specific area of government-required contract provisions.

While a balancing test may be desirable to address novel state *programs* that are typically created by legislation or other publicly accessible procedure, courts and parties will benefit from a simpler way to efficiently identify proprietary versus regulatory action in state contracts while giving due consideration to the important constitutional principles at stake. A functional test specifically for provisions contained in government contracts makes sense because state action accomplished through contracting does not have the same level of public scrutiny or oversight as legislative action or executive rulemaking, but may still pose risks to important commerce clause values. Therefore, this test will be helpful when states adopt across-the-board contracting policies in law, such as Texas's anti-boycott laws, or when a state agency includes a provision in a singular contract without any sort of public process.

This Article describes a new, functions-based taxonomy that courts should use to categorize and evaluate government contract provisions under the Market Participant Exception. This taxonomy is rooted in contracting behavior of private parties and guided by the values animating the Dormant Commerce Clause and Market Participant Exception doctrines, as well as court decisions trying to balance those competing values. This alternative framework will help courts as private parties' contracting behavior changes and states react. This analysis will also prove helpful as states explicitly adopt a strategy to make outsized impacts using their spending power rather than their regulatory power.

IV.
Functions-Based Test

A taxonomy of contract provisions will be helpful to courts in determining whether a contract provision is more at risk of being market regulation rather just market participation. This Article also provides a values-based analysis of each type of provision to support the labeling of each category as clearly permitted under the Market Participation Exception or potentially suspect and deserving of further scrutiny.

This article categorizes provisions appearing in state contracts into four categories based on the function the provision

is performing in the contract.[286] Although it concludes only one category is constitutionally suspect, this level of granularity is helpful because it permits courts to confidently address provisions in contracts for the many and varied goods and services governments buy and sell. The taxonomy roots each category in its function and connects those categories to the values informing courts' balancing tests. With the current balancing tests, a decision by a court that a particular provision is permissible would either require the court to *declare* that the provision passes muster without a fulsome explanation in the interest of judicial economy; or *explain* why the provision is permissible, even if saying so is not controversial, in the interest of judicial transparency. This taxonomy promotes both competing interests—efficiency and transparency—by permitting a court to categorize a provision and reference the analysis provided below. The types of contract provisions are Procedural, Productive, Protective, and Preferential.

A. *Procedural*

First, a contract provision can be procedural. Procedural provisions govern how and when the contract is formed, terminated, and how the parties' rights are enforced. For example, government contracts may include a provision that says the agreement is not valid and binding until it has been approved by a particular governing body. Notice provisions frequently specify how notice from one party to the other must be made (e.g., may be hand-delivered or sent via USPS) and specify the time at which such notice is considered given (e.g., on noon the day after it is sent by overnight courier). Many other "boilerplate" provisions would also fall under this category; for example, a "counterparts" provision clarifies that two separately signed copies of a contract are enforceable as if all signatures appeared on a single document, or a merger clause clarifies that the signed, written agreement contains all applicable terms between the parties. The hallmark of these "procedural" provisions is that they are present in virtually all commercial

286. Ken Adams has a robust taxonomy of contract language based on the function each clause is meant to serve. KEN ADAMS, A MANUAL OF STYLE FOR CONTRACT DRAFTING, ch. 3 (3rd ed., 2012). Adams's taxonomy guides drafters to disambiguate linguistic functions—e.g., language of obligation versus language of discretion—rather than proprietary function.

agreements, by their nature they govern the behavior or rights of the parties as to that contract only, and they do not address the commercial behavior of the parties.

These provisions should not be subject to Dormant Commerce Clause scrutiny because they have no impact on interstate commerce and are therefore outside the scope of the Dormant Commerce Clause entirely. For example, a provision specifying that a contract will not be effective until it is authorized by a county board of supervisors and signed by an authorized representative does not affect the commercial behavior of the parties to the contract and has no impact on either parties' commercial relationships with others.[287]

Alternatively, government procedural provisions absolutely "bear[] the appearance of participating in, rather than regulating, the market"[288] because there is a virtually one-to-one correspondence to procedural terms that appear in fully private agreements: private parties can and do include procedural provisions in their agreements with each other. Even procedural provisions that private parties do not typically include in their agreements but that are required or demanded by the state[289] are permissible because they affect only the non-commercial behavior of the parties to the agreement with no risk of spillover effects.

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287. *See* CNTY. OF L.A., *Sample Master Agreement for Solicitation Number AGR01031*, § 4.1, https://camisvr.co.la.ca.us/LACoBids/AwardLookUp/AwardBidDetail (last accessed Feb. 19, 2025) (relating to weed and vegetation control).

288. Coenen, *supra* note 156, at 441 (quotations omitted).

289. *See, e.g.*, RACINE COUNTY, WIS., HVAC Products, Installation, Labor Based Solutions, and Related Product and Services Contract with Trane U.S., Inc., 2022 https://www.omniapartners.com/suppliers-files/T-Z/Trane/Contract_Documents/3341/3341_TRANE_MAD_HVAC_2022_09_01_.pdf (last accessed June 15, 2025) (permitting the county to cancel the contract "without penalty or obligation of any kind, by County by, for or on behalf of itself or its agencies, departments, officers, agents or employees immediately upon written notice to all parties that sufficient funds have not been budgeted by the County Board of Supervisors to pay the obligations under this agreement.") Although private parties can and do include the right to terminate some contracts for convenience, the systematic inclusion of a right to terminate an agreement any time "termination is in the Government's interest" is exemplary of the kinds of rights governments as contracting parties may be able to demand that private contracting parties cannot. *See, e.g.*, Federal Acquisition Regulation, 48 C.F.R. § 52.249-2(a) (2024).

Procedural provisions do not threaten national unity and free trade. Although they are contained in contracts and therefore involved with interstate commerce, the provisions impact only the parties to the agreement, and only with behavior under the agreement itself. For example, a requirement that a contracting party give notice to the state six months before the contract terminates[290] does not compel that party to give such notice under all of its other agreements. States therefore cannot use procedural provisions to impact behavior outside of the contract itself, much less order the affairs of anyone not a party to the agreement. They also cannot be abused by governments to unfairly create economic advantages for themselves over other states. Notice requirements in individual agreements will not incite the kind of jealousy that could lead to disunity amongst the states.

At the same time, when a state participates in the market by entering into contracts, procedural provisions are an important means by which they protect their economic interests. Procedural provisions ensure states do not unwittingly enter into agreements or renewals and ensure notices are timely and actually received. This is "market participation" and not "market regulation" and is more like the proprietary behavior that is at the core of the Market Participation Exception and justified by all the values underlying the Market Participant Exception.

B. *Productive*

Second, a contract provision might be "productive." Such provisions are directly connected to the subject matter of the contract and "are essential to the feasibility of the contract itself."[291] Productive provisions go to the heart of the bargain being entered, and may include obligations to provide goods or service, a description of those goods and services, standards by which the goods or services are measured, or payment terms. They are an expression of "the parties' direct commercial obligations."[292]

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290. *See* CNTY. OF L.A., *supra* note 288, § 4.3.

291. Inc. Village of Rockville Centre v. Hempstead, 196 F.3d 395, 399 (2d Cir. 1999).

292. South Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 99 (1984).

Whereas many procedural provisions may appear verbatim in many different kinds of contracts,[293] productive provisions will appear in contracts only when they make sense. For example, in a software license agreement between a vendor and a state, the productive provisions may include (i) an obligation by vendor to provide the software; (ii) a license grant from the vendor to the state; (iii) a list of permissible or unpermitted uses of the software by the state; (iv) "net 30" payment terms; and (v) an obligation to pay in United States dollars only. An employment agreement between a company and its chief financial officer would be unlikely to include a software license, but would include provisions related to the CFO's salary and benefits.[294] Each of these terms is *directly* related to the proprietary interest of the contracting party.

When a state purchases a certain type of widget or service (or a combination of both)—to use a real example, electronic monitoring of offenders—the state can pick and choose the product and service provider based on factors related to the widget or performance of the services. The state may choose to buy tracking devices, for example, which are "a one-piece body-attached device" and that do "not have any sharp edges."[295] It may also specify how data is transmitted from the device,[296] how frequently,[297] etc.[298] All of these types of provisions are related to the ostensible purpose of the agreement and are intended to ensure the government receives what it is paying for. The inverse would be true when the government is the vendor—provisions like payment terms, quantities of goods, etc. are all productive provisions needed to give substance to the

293. *Compare* Caterpillar, Inc., Japan Local Currency Addendum § 4.07 (Sep. 1, 2022) https://www.sec.gov/Archives/edgar/data/18230/000110465924096572/tm2423020d1_ex10-3.htm, *with* Brightpoint, Inc., Employment Agreement with Vincent Donargo, (May 10, 2011) https://www.sec.gov/Archives/edgar/data/918946/000095012311048184/c64576exv10w2.htm (both containing sections titled "Execution in Counterparts").

294. *See, e.g.*, Winchester Savings Bank, Employment Agreement with Elda Heller § 3 (Dec. 6, 2024) https://www.sec.gov/Archives/edgar/data/2047235/000119312524276691/d914289dex102.htm.

295. State of Wash., Dep't of Enter. Servs., Cont. & Legal Div., Contract #00212 with Satellite Tracking of People for Electronic Monitoring of Offenders 115 (2013).

296. *See id.* at 99–100.

297. *See id.* at 116.

298. *See generally, id.* at 113–23.

bargain struck. When contracting for the core of the bargain (e.g., "I will do X in exchange for Y."), parties are free to define X and Y as specifically or loosely as they desire to further their own interests.[299]

Unlike procedural provisions, productive provisions govern private, commercial behavior and therefore have the potential to impact interstate commerce. However, there is virtually no risk of an undue burden to interstate commerce because productive provisions, by their nature, affect only the parties to the agreement and affect only the behavior that is essential to effectuate the bargain. The states' ability to influence interstate commerce directly through productive provisions will always be limited because it is expensive: the state must either spend its own money or resources. Productive provisions are unlikely to create the kind of protectionist behavior that the Dormant Commerce Clause was designed to avoid. In fact, states frequently take advantage of the productive provisions negotiated by other states by signing participating addenda and becoming parties to the agreement.[300] States piggy-backing on each other's productive provisions is evidence that these provisions do not impose a threat to national unity or to the free market.

Importantly, when a private party buys or sells goods or services, they negotiate the same kinds of provisions and for the same reasons—to maximize value received under the contract. Just like private parties, when the state is spending its own money,[301] it should be able to craft provisions that ensure it gets the benefit of the bargain it has struck. States are best able to

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299. Technical and hospitality riders by musicians, famous and otherwise, are as illustrative as they are ridiculous. *See, e.g.*, Yusuf Laher, *The Most Ridiculous Tour Riders in History*, Vice Media (June 26, 2012), www.vice.com/en/article/rkq8yr/the-most-ridiculous-riders-in-history.

300. For example, the State of New York awarded a contract to 9 to 5 Seating, LLC, as part of New York's competitive procurement process for furniture. *See* N.Y. State Off. Of Ge. Servs., Contract Award Notification: 9 to 5 Seating, LLC, #PC70151, https://online.ogs.ny.gov/purchase/spg/pdfdocs/2091523295ra.pdf (last accessed June 15, 2025). The State of Florida—having "determined that use of the Master Contract [between vendor and New York] is cost-effective and the best value to the state [of Florida]"—executed a contract enabling it to participate under New York's contract. *See* Fla. Dep't of Mgmt. Servs., Alternate Contract Source (ACS) No. 561200000-24-NY-ACS for Furniture, All Types, Third Recital, https://dms-media.ccplatform.net/content/download/168030/1198235/9to5%20Executed%20Contract.pdf (last visited June 15, 2025).

301. Or, rather, the accumulated money of its citizens that the state is handling on their behalf. *See* Coenen, *supra* note 156, at 422.

exercise their sovereignty and protect their own economic interests by negotiating such provisions unfettered from Dormant Commerce Clause scrutiny. Productive provisions are also where the state can best animate the "the values of local experimentation and optimal responsiveness to local concerns."[302] However fuzzy or unclear the line may be between market participation and regulation, productive provisions are quintessential market participation.

Of course, context matters. What may be a productive provision in one agreement may not be a productive provision in another. For example, there is no problem with the state contractually requiring the GPS tracker company to provide comfortable trackers if the state is hiring them to provide trackers. But if the state is instead buying snooker tables from the company that also sells GPS trackers, the state requiring the company to sell only comfortable trackers cannot fairly be said to be Productive because that requirement is not directly related to state's proprietary interest in the transaction—i.e., the good or service being bought or sold. The unrelated provision would be classified by its function in the transaction and not simply by its form.

C. *Protective*

Some provisions are designed to protect a state's assets involved with or exposed by contract behavior. These "protective" provisions are not an expression of the direct commercial obligations of the party. The essential transaction (X for Y) would still make sense without them. However, the protective provisions are still "essential to the feasibility of the contract";[303] that is, the risks created by the core transaction are too great to justify the transaction absent the protective provisions. This category includes only provisions that address risks raised directly by the contract relationship—i.e., the state would not be exposed to the liability or risk of loss but for entering into the contract with the vendor or buyer. For example, in a software license agreement between the state and a vendor, the state may require the vendor to indemnify the state against any intellectual property infringement claim. The state may also

302. *Id.* at 441.

303. Inc. Village of Rockville Centre v. Hempstead, 196 F.3d 395, 399 (2d Cir. 1999).

require a general indemnification by vendors that the vendor will indemnify the state for any claims brought by a third party arising from the vendor's breach of the agreement. In both instances, the provision is intended to protect the state's proprietary interests that are put at risk directly by the contract.

Protective provisions are present in virtually every commercial agreement between private parties to protect and preserve the parties' assets and determine the outer bounds of their liability vis-à-vis each other. A key feature of protective provisions is that they are directly tied to the risks created by entering into the transaction. For example, when a lender loans money to a borrower, the loan agreement will include not only an obligation to repay the money with interest but will typically also include negative loan covenants that prevent the borrower from taking actions that may materially impact its ability to repay the loan. Other examples include information security obligations to protect a contracting party's data being processed by the other party; confidentiality obligations to prevent disclosure of trade secrets; force majeure provisions to alleviate service obligations under certain circumstances; limitations on liability to cap a party's exposure; and minimum insurance requirements to guard against enumerated risks. In each instance, the provision is one step removed from a risk to a contracting party's proprietary interests involved in the contract.

Protective provisions also include risks to a party that arise not from the transaction under the contract, but by virtue of entering into an agreement with the other party in the first instance. For example, a contract may provide specific remedies for one party's conduct that damages the reputation of the other party. Although unrelated to the subject matter of the contract, these kinds of provisions are still directly related to a risk that arises only because the parties are entering into an agreement. Importantly, private parties can and do include these kinds of relationship-based protective provisions in their agreements. The risk to a unified national market is smaller when states include protective provisions that are similar to those required by private parties; vendors buying or selling to states are no worse off than when they are buying or selling to private parties. The states' participation in the market in that way has no bigger influence on the unified national market than any other participants'.

Protective provisions may be riskier to Dormant Commerce Clause values because they proscribe behavior that falls outside

the essential contract behavior. However, these provisions are closely tied to the core value under the Market Participant Exception of enabling the state to protect its own economic interests. This value justifies not only permitting a state to negotiate the best price (i.e., productive provisions), but also guard against risks associated with entering into the agreement. The state should not be worse off than private parties in a similar position; an inability to include protective provisions in a contract would subject states to more risk than a similarly situated private party purchasing the same goods or services. Provided the state can articulate a risk arising from the contract itself, and the protective provision proscribes or compels behavior associated with the identified risk, states should be permitted to include productive provisions in their agreements without judicial oversight under the Dormant Commerce Clause.

Contracts that require a party to comply with the law fall into this category. No contracting party—public or private—wants its counterparty to run afoul of the law, especially when that behavior could jeopardize the breaching party's ability to perform the contract or risks reputational damage to the non-breaching party. Private parties can and do require their counterparties to generally comply with "Applicable Law," and may require contractual representations about compliance with specific laws relevant to the parties' contractual obligations. In this sense, a provision that merely enforces a party's obligation to comply with an otherwise validly issued law is protective of the party's interest in doing business with law-abiding counterparty. Moreover, a contractual obligation that is coterminous with the law does not ultimately alter the contracting party's behavior because even without the contract provision, the party must comply with the law. These follow-the-law provisions are protective and do not risk offending commerce clause values.

D. *Preferential*

The final category is a catchall category of preferences. These provisions do not govern the internal procedure of the contractual relationship, relate to the interests involved in the core transaction, or address a risk created by entering into the contractual relationship. The hallmark of a preferential provision is that if it was removed from the contract, the state would be no less likely to receive the benefit of the bargain or more likely to incur liability. These provisions are at least two steps

removed from the state's direct, proprietary interests in the contracts.

Consider Microsoft's requirement that its vendors reduce their greenhouse gas emissions.[304] Such a provision is not an expression of the core bargain between the parties; if you remove the obligation, the transaction can still be understood. And it is also not directly related to a risk to Microsoft that arises because it is entering into the agreement with the vendor. Even if Microsoft can articulate an economic risk from climate change, that risk is not directly created by the contractual arrangement with its new vendor.[305] This category is not defined by whether the contracting party has a legitimate or economic interest related to the clause; presumably the party demanding the provision has some interest in its inclusion. But if that interest is neither part of or put at risk because of the bargain, the provision looks more like regulation than participation.

Preferential provisions have the most potential to cause damage to the values the Dormant Commerce Clause was designed to protect. State contracting behavior may balkanize the country because conflicting state requirements in contracts may make it impossible for product and service providers to do business in red and blue states.[306] While one state acting alone may not warrant too much alarm, red or blue states acting essentially in lock step will force companies to choose whether they will provide services to red states or blue states only. This

304. *See* Microsoft Corp., Microsoft Supplier Code of Conduct 14 (2024), https://cdn-dynmedia-1.microsoft.com/is/content/microsoftcorp/microsoft/accex/documents/presentations/Microsoft%20Supplier%20Code%20of%20Conduct.pdf.

305. Climate change almost certainly poses an economic risk to businesses. A 2024 Report on the Risks of Climate Change to the United States in the 21st Century by the Congressional Budget Office found that climate change will negatively impact the supply of labor, productivity, and reduced capital, with a 5% chance that GDP will be 21% lower in 2100 than it would be without climate change. Cong. Bud. Off. The Risks of Climate Change to the U.S. in the 21st Century (December 2024) https://www.cbo.gov/system/files/2024-12/60845-climate-risk.pdf. However, showing a direct causal connection between emissions by one supplier and the economic harm a company incurs will be virtually impossible. Microsoft cites the "social responsibility to protect the environment, conduct environmental due diligence, and promote environmental sustainability," rather than a direct connection between supplier greenhouse gas emissions and risk to Microsoft, as the justification for the environmental portion of its Supplier Code of Conduct. *See* Microsoft Supplier Code of Conduct, *supra* note 304, at 14.

306. Compare reporting requirements to not boycotting.

aligning of economic interests with different political factions is in direct conflict with the free national market envisioned by the drafters.

While a state can and should be able to protect its proprietary interests while contracting, that interest must be weighed against the risk to national unity and the national market. Because preferential provisions by definition do not directly affect a state's proprietary interests, the states' interests as market participants are at their lowest ebb here and are outweighed by the potential risks to national unity and the national market.

One category of preferential provisions deserves special consideration—those that are in service of a state's determination that particular behavior is morally repugnant.[307] Rather than further or protect a state's proprietary or economic interest, morality provisions instead protect the state from doing business with someone whose behavior—even economic behavior—the state finds immoral. Morality clauses should be upheld as market participation after balancing the important interests at stake. On the one hand, morality provisions have the potential to threaten a national market because states may adopt mutually exclusive contract requirements. Because the morality provision is far removed from the state's proprietary interest involved in the transaction, the provision bears a strong resemblance to an attempt to regulate behavior. But if the state goes so far as to conclude that behavior is morally repugnant and harmful to its citizens, it does so as pure exercise of its sovereign authority. By including morality clauses in the Market Participant Exception, courts can give due respect to this exercise of the state's sovereign authority, particularly if the potential harm to interstate commerce is small.

But care must be taken to distinguish between when a state declares something to be morally repugnant under its police powers versus when it is simply expressing a preference for a particular policy or behavior. The state's finding that behavior is morally repugnant should be clear and deliberate. Partisan or economic motivations cast doubt on whether a contract provision is truly included as an exercise of sovereignty or simply the state imposing its will on the market.[308]

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307. *See, e.g.*, Greendorfer, *supra* note 37, at 68.
308. *See* Tri-M Grp., LLC v. Sharp, 638 F.3d 406, 422 (3d Cir. 2011).

Preferential provisions should not receive blanket immunity from Dormant Commerce Clause scrutiny under the Market Participant Exception. Unlike the first three categories where states are acting like market participants and for reasons that fall squarely within the market participant values, when the state requires a Preferential Provision in a contract it poses a risk to national unity without a sufficiently strong countervailing market participant interest to justify no judicial review of that contracting scheme. The constitutional values at stake are too great to permit states to act here without any oversight, even if the actions ultimately pass muster under applicable balancing tests and standards.

This functions-based categorization of contract provisions is rooted in practicality but gives respect to the underlying values competing at the confluence of the Dormant Commerce Clause and the Market Participant Exception. The next section will review a recent government contract to show how each provision can be categorized and justified (or not) as market participation, and highlights how anti-ESG provisions are different than the state's actual market participation.

V.
Anti-ESG Provisions Are Not Market Participation

When viewed under this Article's functions-based categorization, it is clear that anti-ESG provisions are not market participation; or at the very least are not deserving a blanket immunity from judicial scrutiny under the Dormant Commerce Clause. By way of example, Texas's anti-ESG law requires virtually all contracts to contain a verification that the vendor does not and will not boycott oil and gas companies.[309] Because the prohibition applies to "contracts if there are *any* goods or services associated with the contract," the provision can be tested under this Article's approach using any contract.[310]

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309. *See* Tex. Gov't Code Ann. § 2276.002 (2023), https://statutes.capitol.texas.gov/Docs/GV/htm/GV.2276.htm.

310. Ken Paxton, *Advisory on Texas Law Prohibiting Contracts and Investments with Entities that Discriminate Against Firearm Entities or Boycott Energy Companies or Israel 4* (2023), https://texasattorneygeneral.gov/sites/default/files/images/executive-management/OAG%20advisory%20on%20SB%2013%20and%2019%2010.18.23.pdf.

Texas signed an agreement with a Delaware company in November 2022 for "Accessibility, Assistive Technologies, and Related Products and Services."[311] The purpose of the contract was to satisfy "statewide procurement requirements for accessibility, assistive technologies, and related products and services and improve[] the efficiency of the procurement process by shortening the time required to procure accessibility, assistive technologies, and related products and services."[312] The contract itself contains numerous procedural provisions, including a provision establishing the order of precedence of the various contract documents and appendices[313] and a provision governing notice under the contract.[314]

Not surprisingly, the bulk of the contract consists of productive provisions. These include establishing the term during which the vendor is required to provide the goods and services,[315] fixing the price for the enumerated goods and services,[316] establishing an administrative fee that the vendor must pay to Texas for purchases made under the agreement,[317] permitting third parties to fulfil orders,[318] setting rules for the use of software acquired under the agreement,[319] and specifying the terms of service.[320] These provisions are the expression of the core bargain, as identified by the explicit purpose statement in the RFO. They identify what the state-as-trader is getting and what it is giving up in exchange.

The contract also includes numerous protective provisions that seek to ensure the state receives the benefit of the bargain and to protect against risks associated with entering into

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311. State of Tex., Dep't of info. Res., Contract for Product, Services, and Related Services *§ 1.1* (2022), https://txdir.widen.net/view/pdf/e6b0vzjiky/DIR-CPO-5116-Contract.pdf?t.download=true&u=tmwul0.

312. State of Tex., Dep't of info. Res., Request for Offer, Accessibility, Assistive Technologies, and Related Products and Services DIR-CPO-TMP-555, at 225 (2021), https://txdir.widen.net/view/pdf/idcb-2pvsc3/DIR-CPO-5116-RFO-DIR-CPO-TMP-555.pdf?t.download=true&u=tmwul0.

313. *See* State of Tex., Dep't of info. Res., *supra* note 311, at § 1.3.

314. *See id.* § 9.

315. *See id.* § 2.

316. *See id.* §§ 5, 5.4. (specifying that the prices include shipping and handling).

317. *See id.* § 6 (also allowing DIR to unilaterally change the fee).

318. *See id.* § 8.

319. *See id.* § 10.

320. *See id.* § 10.2.

the agreement.[321] For example, the state secured a best price clause that guarantees the pricing to the state matches the best pricing the vendor offers to any other customer, regardless of the pricing fixed in the pricing index.[322] Although the vendor is permitted to use third parties to fulfill orders, the contract clarifies that the vendor is fully liable for those third parties' performance.[323] The contract fixes the process whereby the vendor may increase prices, but gives the state the right to require that the vendor honor the old price or remove the product from the contract.[324] These provisions all serve to protect the state's proprietary interest in the agreement and ensure the state receives the bargain it made in the productive provisions.

The contract also includes relationship-based protective provisions meant to address risk to the state that arises from it entering into the agreement with the vendor. Thus, the state can require the vendor "provide proof of financial stability prior to or at any time during the Contract term."[325] The vendor is required to indemnify the state for any acts or omissions by the vendor in connection with the entering into the agreement.[326] The vendor certifies that it complies with a long list of laws, including for example antitrust laws,[327] and the state reserves the right to terminate the agreement unilaterally if it discovers "potentially criminal violations by the [vendor], whether or not such potential violations directly impact the provision of goods or services under the Contract."[328] These provisions are intended to ensure the vendor has and will continue to have the wherewithal to perform under the agreement, ensure the vendor follows the law, and protects the state's reputation in the event of an unrelated criminal violation. All are directly connected to a risk associated with contract behavior or by nature of entering into a commercial relationship with the vendor. There is a direct connection between the vendor behavior

321. *See id.* §§ 3–7.
322. *See id.* § 5.2(c).
323. *See id.* § 8.2(d).
324. *See id.* § 5.3.
325. *See* State of Tex., Dep't of Info. Res., Standard Contract Terms and Conditions § 4.8 (2022), https://txdir.widen.net/view/pdf/jjknxlwbpx/DIR-CPO-5116-Appendix-A-Standard-Terms-and-Conditions.pdf?t.download=true&u=tmwul0.
326. *See id.* § 10.1.1.
327. *See id.* § 10.4(A).
328. *Id.* § 11.2.5.

required or proscribed and the state's proprietary interest (or risk to the state's proprietary interest). A private party purchasing the same services would include the same provisions, so the state is truly behaving as a market participant would.

Finally, there are a handful of provisions that are expressions of state preferences. These Provisions are included in the "Successful Respondent Certifications," and include in relevant part:

> [I]n accordance with Section 2271.002, Texas Government Code, by signature hereon, Successful Respondent does not boycott Israel and will not boycott Israel during the term of the Contract . . . .
>
> . . . .
>
> . . . [I]f Successful Respondent is required to make a verification pursuant to Section 2274.002, Texas Government Code, Successful Respondent verifies that it does not boycott energy companies and will not boycott energy companies during the term of the Contract . . . .
>
> . . . .
>
> . . . [I]f Successful Respondent is required to make a verification pursuant to Section 2274.002, Texas Government Code, Successful Respondent verifies that it (A) does not have a practice, policy, guidance, or directive that discriminates against a firearm entity or firearm trade association and (B) will not discriminate during the term of the contract against a firearm entity or firearm trade association[.][329]

The anti-Israel boycott provision is discussed briefly below. But whether the vendor uses oil and gas versus clean energy, or chooses to bid (or not) on firearm industry contracts does not have any direct relationship with the vendor's ability to provide the requested accessibility services. Choosing to dissociate from oil and gas companies does not appear to make it more or less likely that the state will receive the accessibility products and services it has bargained for in the agreement. There is nothing in the RFO indicating that the state believes the provision of accessibility services will be more reliable, for example, if the

329. *Id.* § 10.4(b)(xvii), (xx), (xxi).

vendor uses fossil fuels. There is also no indication that Texas believes the provision of accessibility services will be more unreliable if the vendor elects to avoid doing business with firearms companies. There is no direct or proximate tie between the proscribed vendor behavior and any fairly articulable proprietary interest of the state of Texas.

The anti-boycott provisions do not bear the marks of market participation because they do not protect a proprietary interest or a risk the state is exposed to because of entering into the contract. Instead, the state is using a contract to order the commercial activities of a private party that are at least several steps removed from the activity required by the contract. The state may well be able to prohibit a party from boycotting certain industries. However, when the state has not articulated a proprietary interest, it cannot be fairly said to be solely participating in the market and avoid any judicial oversight. In these circumstances, courts should have the ability to consider whether the risk to Dormant Commerce Clause values is outweighed by whatever sovereign interest the state may be expressing through the contract.

Texas may argue that its anti-boycott law is similar to laws that ban unethical behavior (such as child labor, public morals, etc.).[330] In the *Pork* case, the law specifically referred to certain pork production as "cruel," which directly roots that law in terms of public morals, notwithstanding that it also had an effect on commerce.[331] The Texas law contains no such morality language. And although it is copied from anti-Israel boycott laws, which are at least permissibly rooted in state attempts to deal with rising anti-Semitism and therefore police power or at least public morals, the anti-boycott laws are primarily economic.[332] Texas may have a possible morality argument against use of ESG factors because of arguments that ESG may be used to discriminate against people.[333] But not being able to use ESG factors in credit or investment decisions, for example, is

330. *See, e.g.*, Nat'l Pork Producers Council v. Ross, 598 U.S. 356, 381 (2023) (citing Transcript of Oral Argument at 51, *Nat'l Pork Producers Council*, 598 U.S. 356 (2023) (No. 21-468)); W. Union Tel. Co. v. James, 162 U.S. 650, 653 (1896).

331. *See Nat'l Pork Producers Council*, 598 U.S. at 381.

332. *Compare* Tex. Gov't Code Ann. § 2271 (2019), *with* Tex. Gov't Code Ann. § 809 (2021).

333. *See* Danielle Moran, *Why Texas Is Banning Banks Over Their ESG Policies*, Bloomberg (Mar. 20, 2024), https://www.bloomberg.com/news/

different than not being able to choose which energy providers to use. If Texas or other states with similar laws wish to ensure their decisions are protected as sovereign expressions of public morals, courts should require states to make such expressions deliberately and unambiguously.

Importantly, anti-boycott laws—at least those protecting fossil fuel and firearms companies—do not appear in entirely private contracts.[334] When the state adopts a provision such as this, comparing the state's contracting behavior "with the typical behavior of private parties in similar circumstances"[335] demonstrates that the state is motivated *not* by a desire to protect its own proprietary interests, but by something else. States should not be able to avoid judicial scrutiny under the Market Participant Exception when the state is protecting something other than a proprietary interest.

These anti-ESG provisions are ripe for Dormant Commerce Clause review because they give a single state undue influence in the national, unified market and risk balkanizing the country. The compulsory contract provision is absolute; it applies to *all* economic behavior of the contracting party, and not just the party's performance under or related to the contract. A company may not simultaneously agree not to reduce its commercial relationships with fossil fuel companies *and* actively reduce its greenhouse gas emissions by switching to clean energy, for example. This either-or choice cleaves what is supposed to be a unified national market into two parts—states that will do business with you as long as you continue to do business with fossil fuel companies, and the rest.[336] Companies will increasingly have to choose with which bloc to do business, risking balkanization of the private sector into red and blue companies. Where the risk to the Dormant Commerce Clause value of a unified national market is great, and—as demonstrated in this Article—the state's putative proprietary interest

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articles/2024-03-20/why-texas-is-banning-blackrock-citi-other-banks-over-esg-investing?embedded-checkout=true.

334. In fact, the trend has been to require vendors to reduce their reliance on oil and gas. *See supra* Part III.

335. *Cardinal Towing*, 180 F.3d at 693.

336. This is particularly true as other states adopt laws requiring ESG reporting, including on companies' effort to reduce risk associated with climate change. *See, e.g.*, CAL. HEALTH & SAFETY CODE § 38533 (West 2025) (requiring covered companies to report "measures adopted to reduce and adapt to climate-related financial risk").

in these preferential provisions is low, courts should have the ability to weigh "whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits."[337]

Conclusion

The values animating the Dormant Commerce Clause—namely preventing balkanization and preserving national unity—are as important now as they were at the time the commerce clause was drafted. Increased political divisions amongst the states and general populace make guarding against balkanization perhaps even more important. Although states should enjoy broad discretion when acting on and protecting their proprietary interests as market participants, that deference cannot be without limit. By categorizing state contract provisions into four functional categories, courts will be able to quickly and fairly identify which contract provisions fall squarely under the Market Participant Exception and which are potentially suspect. State preferences in contracts are not justified under the Market Participant Exception and put at risk important Dormant Commerce Clause values that courts should be permitted to consider. This Article does not address whether a state preference should ultimately pass muster under the Court's Dormant Commerce Clause.

This Article addresses only one of the many anti-ESG laws being passed by numerous states. Further analysis is needed to determine whether other anti-ESG laws are also constitutionally suspect under the Dormant Commerce Clause. Further analysis could also include whether a state's procurement preference for a vendor that complies with anti-boycott laws is less deleterious to national unity than a contractual ban on the same behavior. Finally, what impact would a clearly expressed federal policy related to boycotting oil and gas companies, or the use of ESG factors in vendor decision-making, have on the states' ability to demand compliance with their own policies?

337. Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 579 (1986).

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COMMENTARY ON REGULATING BY CONTRACT: PREFERENCE OR PROTECTION? ANTI-ESG LAWS IN CONTEXT

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INTRODUCTION

This Comment reacts to the new functions-based framework for contractual provisions proposed by Prof. Smith by asking one fundamental question: namely, why did lawmakers in nearly half of the states propose, and ultimately enact, so-called "anti-ESG laws" between 2021 and 2023? In answering this question, this Comment looks to historical context, and concludes that anti-ESG legislative activity was a direct response to actions taken by many of the world's largest financial institutions in relation to the perceived threats of climate change; specifically, the joining of certain climate-specific membership groups and the accompanying public commitments and pledges made by financial institutions to adopt investment restrictions and engagement

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strategies designed to achieve "net zero" greenhouse gas emissions. This conclusion is supported by a close textual analysis of the three main types of "anti-ESG" laws, which this Comment elaborates upon in Part II. Part III concludes that, because anti-ESG laws were fundamentally aimed at the financial sector and designed to protect the vital economic interests of states that rely on carbon-intensive sectors like energy and utilities, the contractual provisions that flow from these laws are more properly classified as "Protective" provisions rather than "Preferential" provisions, as suggested by Prof. Smith.

I.
Historical Context

So-called "anti-ESG" laws are a relatively new phenomenon in the U.S. legal landscape. In fact, none existed prior to 2021. It is worth pausing to ask why state lawmakers felt compelled to engage in this legislative activity at that particular moment in time. While Prof. Smith suggests that anti-ESG laws are simply an offshoot of previously enacted anti-BDS laws relating to boycotts of Israeli companies, this Comment proposes an alternative theory: namely, that these laws were, in fact, a direct response to a growing number of the world's largest financial institutions joining climate-focused membership groups and making public pronouncements that were, perhaps understandably, perceived as posing a direct threat to the continued health of many states' local economies.

Indeed, the world's three largest institutional investors—BlackRock, State Street, and Vanguard—joined the likes of Climate Action 100+ ("CA100+") and the Net Zero Asset Managers Initiative ("NZAMI") before any anti-ESG laws were enacted in any state. Blackrock became a signatory to CA100+ on January 9, 2020,[1] and State Street joined CA100+ on November 30, 2020.[2] Not long thereafter, all three firms also

1. *BlackRock Joins Climate Action 100+ to Ensure Largest Corporate Emitters Act on Climate Crisis*, Climate Action 100+ (Jan. 9, 2020), https://www.climateaction100.org/news/blackrock-joins-climate-action-100-to-ensure-largest-corporate-emitters-act-on-climate-crisis/.

2. *State Street Global Advisors Becomes Latest Signatory To Climate Action 100+*, Climate Action 100+ (Nov. 30, 2020), https://www.climateaction100.org/news/state-street-global-advisors-becomes-latest-signatory-to-climate-action-100/.

became signatories to NZAMI. BlackRock and Vanguard joined NZAMI on March 29, 2021.[3] State Street quickly followed suit, becoming a signatory to NZAMI on April 20, 2021.[4] While it is worth noting that these firms, among many others, have since abandoned these groups, with NZAMI recently taking the extraordinary step of temporarily suspending its operations[5], it remains an historically important fact that, at the time, the membership of these groups had grown to nearly 700 institutional investors who collectively managed $68 trillion in assets under management.[6]

Membership in such groups required firms to commit to influencing corporate policies at the companies in which they invest. For example, CA100+ members committed to: (i) "[t]ake action to reduce greenhouse gas emissions across the value chain in line with the overarching goals of the Paris Agreement"; (ii) "[i]mplement a strong governance framework which clearly articulates the board's accountability and oversight of climate change risks and opportunities"; and (iii) monitor compliance with carbon output reduction targets by "[p]rovid[ing] enhanced corporate disclosure in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)."[7]

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3. *The Net Zero Asset Managers Initiative*, Blackrock (Sept. 17, 2024), https://web.archive.org/web/20221204013435/https://www.netzeroassetmanagers.org/signatories/blackrock/; *The Net Zero Asset Managers Initiative*, Vanguard (Dec. 4, 2022), https://web.archive.org/web/20221204011812/https:/www.netzeroassetmanagers.org/signatories/vanguard/.

4. *Net Zero Asset Managers Initiative*, State Street Global Advisors (last visited Sept. 18, 2024), https://web.archive.org/web/20240518232804/https://www.netzeroassetmanagers.org/signatories/state-street-global-advisors-2/.

5. *Climate Action 100+ Reaction To Recent Departures*, Climate Action 100+ (Feb. 26, 2024), https://www.climateaction100.org/news/climate-action-100-reaction-to-recent-departures/; *Update From The Net Zero Asset Managers Initiative*, Net Zero Asset Managers Initiative (Jan. 13, 2025), https://www.netzeroassetmanagers.org/update-from-the-net-zero-asset-managers-initiative/.

6. *Progress Update 2023*, Climate Action 100+ (Jan. 2024), https://www.climateaction100.org/wp-content/uploads/2024/01/Climate-Action-100-Progress-Update-2023.pdf. These departures and defections are attributable, at least in part, to increased legal and Congressional antitrust scrutiny of these membership groups. *See, e.g.*, Complaint at 1, State v. Blackrock, No. 6:24-cv-00437 (E.D. Tex. filed 2024) (alleging that BlackRock, Vanguard, and State Street violated antitrust laws through climate activism that reduced coal production and drove up energy prices).

7. *The Three Asks*, Climate Action 100+ (Mar. 3, 2021), https://web.archive.org/web/20210303172551/https://www.climateaction100.org/approach/the-three-asks/.

Similarly, NZAMI signatories pledged to: (i) "[w]ork in partnership with asset owner clients on decarbonization goals, consistent with an ambition to reach net zero emissions by 2050 or sooner across all assets under management"; (ii) "[s]et an interim target for the proportion of assets to be managed in line with the attainment of net zero emissions by 2050 or sooner"; (iii) "review [one's] interim target at least every five years, with a view to ratcheting up the proportion of AUM covered until 100% of assets are included"; and (iv) "comprehensively implement [a] stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with [the] ambition for all assets under management to achieve net zero emissions by 2050 or sooner."[8]

It is not difficult to see how these types of commitments made by such a large and influential group of financial institutions posed both a financial and existential risk to companies that operate in highly carbon-intensive industries, and by extension, the GDP and economic vitality of states whose local economies rely disproportionally on those industries for jobs, tax revenues, and economic growth.

With this historical context in mind, it is, therefore, not surprising that anti-ESG legislation was introduced shortly thereafter. Indeed, the Texas energy boycott law—the first of its kind—was introduced into the Texas Senate on March 11, 2021, in the midst of the rapid growth in membership at groups like CA100+ and NZAMI. The bill was quickly passed in both chambers by large margins, and took effect on September 1, 2021.[9]

II.
Three Types of Anti-ESG Laws

Subsequent to the enactment of the Texas energy boycott law, the anti-ESG legislative trend spread quickly to other jurisdictions. In fact, in just two years, the number of anti-ESG laws

8. *Commitment*, The Net Zero Asset Managers Initiative, https://perma.cc/L7MAX-HUAT

9. Tex. S.B. 13, 87th Leg., Reg. Sess. (2021). On May 28, 2021, SB 13 passed 121-26-1 in the House, and 28-3 in the Senate.

that had been enacted and taken effect quickly grew from just three (3) at the end of 2021,[10] to more than 30 laws across 19 different states by the end of 2023.[11] While all of these new laws have fallen under the umbrella of "anti-ESG", they are not, in fact, homogeneous. This Comment identifies three distinct types of anti-ESG laws: (1) anti-boycott laws; (2) amendments to fiduciary duty statutes; and (3) anti-discrimination laws, which are described in more detail below. Importantly, despite these distinctions, the common thread across all three types of anti-ESG laws is their specific application to the financial sector, and the managers of state funds in particular, which further supports the conclusion above regarding the original purpose and intent of anti-ESG legislation.

A. *Anti-Boycott Laws*

Twelve states enacted anti-boycott laws between 2021 and 2023. These laws generally take two forms: (1) laws that prohibit state governmental entities from entering into certain contracts with counterparties that are deemed to boycott a particular industry, and/or requiring a written certification that the counterparty does not engage in economic boycotts[12]; and (2) laws that require state funds to be divested from, or

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10. Tex. Gov't Code Ann. §§ 809.001–.057, 2274.001–.010 (West 2021); N.D. Cent. Code § 30.1-18-03 (2021), 59-16.1-01 to -07 (2021).

11. 2022 Effective Dates: Ky. Rev. Stat. §§ 41.472-41.480 (2022); Energy Discrimination Elimination Act of 2022, Okla. Stat. tit. 74 §§ 12001-.12002 (2022); W. Va. Code §§ 12-1C-1 to -7 (2022); Idaho Code §§ 67-2345-67-2347 (2022). 2023 Effective Dates: Ala. Code §§ 41-16-160 to -166 (2023); Ark. Code Ann. §§ 25-1-110, -1102 (2023); Idaho Code § 67-2347(a) (2023); Ind. Code Ann. §§ 5-10.2-14-1 to -13 (2023); La. Rev. Stat. Ann. § 38:2216.1 (2023); Mont. Code Ann. § 30-20-301 (2023); Tenn. Code Ann. § 9-4-107 (2023); Utah Code Ann. §§ 63G-27-101 to -102 (2023); Ark. Code Ann. §§ 24-2-801 to -806 (2023); Fla. Stat. Ann. §§ 17.57, 112.662, 215.47, 218.415 (2023); Ind. Code Ann. §§ 5-10.2-14-1 to -13 (2023); Kan. Stat. Ann. § 75-42(a)-03 (2023); Ky. Rev. Stat. §§ 21.450, 61.650 (2023); Mont. Code Ann. §§ 17-6-231 to -232 (2023); N.H. Exec. Order No. 2023-03 (2023); N.C. Gen. Stat. § 147-69.7 (2023); S.C. Code Ann. §§ 9-16-10 to -110 (2023); Tenn. Code Ann. §§ 9-4-1401 to -1404 (2023); Utah Code Ann. §§ 49-11-203, 51-7-14 (2023); W. Va. Code §§ 12-6-11(a), 12-6(c)-13 (2023); Ark. Code Ann. §§ 25-1-1101 to -1107 (2023); Fla. Stat. Ann. § 655.0323 (2023); Idaho Code § 67-2739 (2023); Kan. Stat. Ann. § 75-42(a)-02 (2023); N.D. Cent. Code § 26.1-04-03 (2023); Tex. Ins. Code § 565.005 (2023); Utah Code Ann. §§ 63G-29-101 to -201 (2023).

12. *See, e.g.*, W. Va. Code §§ 12-1C-1 to 12-1C-7 (authorizing the State Treasurer to maintain a list of financial institutions that are engaged in a boycott

otherwise restrict state funds from being allocated to, financial companies that are deemed to have engaged in a boycott of a particular industry.[13]

In both cases, however, the boycotted industries in question are narrowly tailored, and many focus exclusively on the energy sector. For example, the Kentucky, Louisiana, Montana, Oklahoma, Tennessee, Texas, and West Virginia laws contain a single-industry anti-boycott prohibition (i.e., energy or fossil fuels, or firearms). A few states, including Alabama, Arkansas, Idaho and Utah, have enacted anti-boycott laws that are broader and encompass boycott activities against several industries, such as fossil fuels, timber, mining, and agriculture.[14] With the exception of two firearms-specific boycott laws,[15] all other anti-boycott laws explicitly reference "energy" or "fossil fuels."

While there is a meaningful distinction between requiring contract counterparties to certify to something in writing and the production by a state official of a list of companies that are prohibited from doing business with the state, the practical effect of these anti-boycott laws is fundamentally the same – namely, they seek to *protect* states' economic interests by preventing large financial institutions from refusing to lend to, underwrite, or otherwise do business with companies in a particular industry.

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of energy companies and making any such institutions ineligible to enter into, or remain in, banking contracts with the State of West Virginia).

13. *See, e.g.*, Energy Discrimination Elimination Act of 2022, Ok. Stat. §§ 12001-12006 (authorizing the State Treasurer to maintain a list of financial companies that have engaged in energy company boycotts and requiring all state governmental entities to divest from their direct and indirect holdings managed by any such listed financial companies).

14. *See, e.g.*, Ala. Code § 41-16-161 (requiring state governmental entities entering into contracts for goods and services in excess of $15,000 to obtain a written verification from the counterparty that it does not engage in economic boycotts relating to, inter alia, fossil fuel-based energy, timber, mining, agriculture, firearms, or ammunition).

15. *See*, Mont. Code Ann. § 30-20-301 (requiring state governmental entities entering into contracts for goods or services in excess of $100,000 to obtain a written certification from the counterparty that it does not discriminate against firearm entities or firearm trade associations.); Tex. Gov't Code §§ 2274.001-2274.003 (requiring state governmental entities entering into contracts for goods or services in excess of $100,000 to obtain a written verification from the counterparty that it does not and will not during the term of the contract, discriminate against a firearm entity or firearm trade association).

B. *Amendments to Fiduciary Duty Statutes*

Unlike the anti-boycott laws, fiduciary duty statutes are not new and are generally well understood as articulating a prudent, or reasonable, investor standard. However, between 2021 and 2023, at least 14 states[16] enacted laws that amended their fiduciary duty statutes to add two new elements: (1) prohibiting or restricting the consideration of "non-pecuniary" environmental, social, or governance factors when making allocation or investment decisions; and/or (2) authorizing the state attorney general to investigate and enforce breaches of fiduciary obligations owed to the state by third-party asset managers.

Like the anti-boycott laws, fiduciary duty amendments have been narrowly tailored to apply only to certain fiduciaries of state assets.[17] Notably, none of these recent amendments to fiduciary duty statutes excluded fiduciaries of state pension assets.

Unlike the anti-boycott laws, these amendments apply exclusively to the subset of financial firms that are in the business of managing state funds and would not, for example, be applicable to the myriad providers of other goods and services that states normally contract for, where there is typically no fiduciary relationship because they do not entail the management of state assets. In other words, the impact of these amendments to fiduciary duty statutes, by the very nature of the underlying

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16. Ark. Code § 24-2-801 et seq.; H.B. 3, 2023 Leg., Reg. Sess. (Fla. 2023) (enacted); Idaho Code § 67-2345; Ind. Code § 5-10.2-14 et seq.; Kan. Stat. Ann. § 2002 Supp. 74-4921; Ky. Rev. Stat. Ann. § 61.650 (West) (effective June 29, 2023); H.B. 228, 68th Leg., Reg. Sess. (Mont. 2023); N.H. Rev. Stat. Ann. § 6:8, II(f) (effective August 29, 2023); N.C. Gen. Stat. Ann. § 147-69.7(b)(5) (West) (effective June 27, 2023); N.D. Cent. Code § 21-10-08.1 (effective Aug 1, 2023); S.C. Code Ann. §§ 9-16-50(5), -110 (effective Feb. 5, 2024); Tenn. Code Ann. §§ 9-4-1401 to -1402 (effective May 17, 2023); Utah Code Ann. § 49-11-203 (West) (effective May 3, 2023); W. Va. Code Ann. § 12-6-11a (effective June 8, 2023).

17. *Compare* S.C. Code Ann. § 9-16-50(5) (requiring the South Carolina Retirement System Investment Commission to "only…consider pecuniary factors in making an investment decision or when allocating capital to an investment strategy") *with* Tenn. Code Ann. §§ 9-4-1401 to -1402 (requiring the Tennessee Department of Treasury investment division staff to "invest, reinvest, manage, and select investment options for program assets for financial reasons for the exclusive benefit of the beneficiaries of the programs while maximizing long-term shareholder value," where "program" is defined to capture any trust fund, endowment fund, deferred or tax-sheltered compensation plan, etc. over which the state treasurer has, or has been delegated, investment authority, oversight and responsibility).

laws, is limited to only those financial firms acting as fiduciaries for state assets, and therefore, this category of anti-ESG laws have also been narrowly tailored to address the potentially problematic boycott activities of certain financial institutions.

C. *Anti-Discrimination Laws*

The third category of anti-ESG laws can best be described as "anti-discrimination" laws which, in general, either prohibit: (1) financial and/or insurance companies from using so-called "ESG" or "social" credit scores when deciding whether to lend to, or extend an insurance policy to, any individual or entity; and/or (2) state agencies from utilizing ESG or social credit scores when evaluating bids submitted for state government procurement contracts. Seven states enacted such laws, all of which took effect in 2023.[18]

In comparison to the other two types of anti-ESG laws discussed above, the anti-discrimination laws are arguably the most heterogenous in the sense that they prohibit both private sector and public sector actors from utilizing ESG and/or social credit scores across a variety of circumstances. For example, the Idaho law applies only to public entities and state educational institutions engaging in government procurement contracting.[19] The Texas anti-discrimination law, on the other hand, applies only to "insurance policies issued and delivered by an insurer" in Texas.[20] The North Dakota anti-discrimination law applies to both the state investment board *and* insurers,[21] while the Arkansas anti-discrimination law applies only to insurers and financial institutions and does not include any prohibitions applicable to state agencies or officials.[22]

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18. Ark. Code Ann. §§ 25-1-1001 to -1002 (effective Aug. 1, 2023); Fla. Stat. Ann. § 215.681 (effective May 7, 2024), Fla. Stat. Ann. §§ 516.037, 560.1115, 655.0323 (effective July 1, 2023); Idaho Code §§ 54-4511(10), 67-2347, 67-5711A, 67-5711C(8), 67-9210(1), 67-9225(3)(a)-(c) (effective July 1, 2023); Kan. Stat. Ann. §§ 74-4921(4), 74-4921(7)(C), 74-4921(2)(a)-(b), 74-4921(4)(b) (effective July 1, 2024); N.D. Cent. Code §§ 21-10-08.1(1), 26.1-04-03 (effective Aug. 1, 2023); Tex. Ins. Code Ann. §§ 565.001, 565.005 (effective Sept. 1, 2023); Utah Code Ann. § 63G-29-101 (effective May 1, 2024); Utah Code Ann. § 63G-29-201 (effective May 3, 2023).

19. Idaho Code §§ 54-4511(10), 67-2347, 67-5711A, 67-5711C(8), 67-9210(1), 67-9225(3)(a)-(c) (effective July 1, 2023).

20. Tex. Ins. Code Ann. § 565.003(a) (effective Sept. 1, 2023).

21. N.D. Cent. Code §§ 21-10-08.1(1), 26.1-04-03 (effective Aug. 1, 2023).

22. Ark. Code Ann. §§ 25-1-1001 to -1007 (effective Aug 1, 2023).

Despite the heterogeneity of these laws, those that include prohibitions on private sector activities—like the other types of anti-ESG laws discussed above—are also narrowly tailored to apply only to financial and insurance sector companies conducting business in the state.

III.
Anti-ESG Laws as Protection, Not Preference

With the benefit of historical context and a closer inspection of the types of anti-ESG laws, one can see how these laws—and by extension, the contractual provisions that flow from some of them—could be characterized as "Protective" provisions and not as expressions of state preference. Prof. Smith acknowledges that protective provisions "also include risks to a party that arise not from the transaction under the contract, *but by virtue of entering into an agreement with the other party in the first instance*",[23] including provisions designed to insulate a party from reputational risks that may arise from the counterparty's conduct, and the obligation to comply with all applicable laws.[24] Where anti-ESG laws require provisions in government contracts, they address all of these risks. They protect a governmental party from the reputational risk that a fiduciary of state assets will not use its influence in the financial markets to simultaneously harm a state's vital economic interests in a particular industry. They also, at a more fundamental level, simply require that the counterparty represent that it is not in violation of applicable state law at the time the contract is executed and will not violate applicable state law during the term of the agreement.

Conclusion

In conclusion, this Comment suggests that while anti-ESG laws encompass three materially different types of legislation, they all share the common thread of being a direct response by state lawmakers to the actions taken by a number of large and influential financial institutions, and were drafted accordingly. State lawmakers who viewed these public statements and commitments to reduce GHG emissions at investee companies

23. Nicholas A. Smith, *Regulating by Contract: A Functions-Based Approach to Anti-ESG Laws*, 21 N.Y.U. J. L. & Bus. 305, 353 (2025) (emphasis added).
24. *Id.*

and achieve "net zero" emissions sought to protect their states' economic interests by prohibiting financial institutions from boycotting these interests, mitigating reputational risk to the state's contracting party, and ensuring that the contractual counterparty is, and will continue to be, in compliance with applicable state law. Accordingly, such "anti-ESG" provisions in contracts can be construed as "Protective" provisions, not "Preferential," under Prof. Smith's proposed framework.