

ORIGINAL

**SUPREME COURT
OF THE UNITED STATES**

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In the Matter of:)	
)	
NEW ENERGY COMPANY OF INDIANA,)	
)	No. 87-654
Petitioners)	
v.)	
)	
JOANNE LIMBACH, TAX COMMISSIONER)	
OF OHIO, ET AL.)	

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IN THE SUPREME COURT OF THE UNITED STATES

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NEW ENERGY COMPANY OF INDIANA, :

Appellant, :

v. :

No. 87-654

JOANNE LIMBACH, TAX COMMISSIONER :

OF OHIO, ET AL. :

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Washington, D.C.

Tuesday, March 29, 1988

The above-entitled matter came on for oral argument
before the Supreme Court of the United States at 10:41 a.m.

APPEARANCES:

HERMAN SCHWARTZ, Washington, D.C.;

on behalf of the Appellant.

RICHARD C. FARRIN, ESQUIRE, Assistant Attorney General of

Ohio, Columbus, Ohio;

on behalf of the Appellees.

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1 P R O C E E D I N G S

2 (10:41 a.m.)

3 CHIEF JUSTICE REHNQUIST: We'll hear argument next in
4 No. 87-654, New Energy Company of Indiana versus Joanne
5 Limbach.

6 Mr. Schwartz, you may proceed whenever you're ready.

7 ORAL ARGUMENT OF HERMAN SCHWARTZ, ESQUIRE

8 ON BEHALF OF THE APPELLANT

9 MR. SCHWARTZ: Mr. Chief Justice, and may it please
10 the Court.

11 This is an appeal by the New Energy Company of
12 Indiana, an Indiana ethanol producer, from the fourth
13 redecision of the Ohio Supreme Court on rehearing that rejected
14 New Energy's Commerce Clause challenge to a 1984 amendment to
15 Ohio's sales tax credit for the gasoline ethanol blend or 90\10
16 blend known as gasohol.

17 Prior to 1985, Ohio had granted a credit to the motor
18 vehicle fuel tax for gasoline for gasohol. On December 20,
19 1984, it amended the statute by denying the credit to gasohol
20 containing ethanol produced in another state unless that
21 foreign producer state grants a credit to ethanol sold there
22 containing Ohio produced ethanol. The credit that Ohio grants
23 is limited the amount of credit granted Ohio ethanol in that
24 other state.

25 Now, although the Ohio courts agreed that the

1 reciprocity provision effectively excluded New Energy from the
2 Ohio ethanol market, they nevertheless upheld it. Our position
3 is that this 1984 amendment which was conceded by the Supreme
4 Court of Ohio to be a forced reciprocity statute discriminating
5 against out-of-state products by denying the tax credit unless
6 the out-of-state product's home state provides a similar tax
7 credit, must pass a strict scrutiny test, and that this clearly
8 does not.

9 QUESTION: Mr. Schwartz, what if all we had in front
10 of us was an Ohio statute that granted a tax credit to
11 producers of ethanol in Ohio, no reciprocity provision. Would
12 you be here, and would you think that posed a commerce clause
13 problem?

14 MR. SCHWARTZ: Yes, Your Honor, if it grants a tax
15 credit only to Ohio ethanol, yes, Your Honor.

16 QUESTION: Do you think that would be true if Ohio
17 had a serious concern about its citizens' health problems?

18 MR. SCHWARTZ: Yes.

19 QUESTION: Do you think it couldn't provide a tax
20 credit to encourage the production and use of ethanol in Ohio?

21 MR. SCHWARTZ: Yes. But that is the kind of
22 protection that must meet the strictest of all scrutiny. It's
23 almost per se illegal, that kind of tax credit, as this Court
24 has found. A tax credit that's limited solely to the in state
25 product.

1 QUESTION: Well, let me ask you this. Do you think
2 that Ohio could, instead of a tax credit, give some kind of
3 bonus payment to producers of ethanol in Ohio?

4 MR. SCHWARTZ: Yes. And States have done that.

5 QUESTION: It could do that?

6 MR. SCHWARTZ: Yes. And States have done that.

7 QUESTION: You don't think that a tax credit is
8 essentially the same thing as a bonus?

9 MR. SCHWARTZ: No, it's not, Your Honor. A tax
10 credit is aimed in the form in which you've raised it, it is
11 aimed almost explicitly at out of state producers. It says,
12 our people will get this. It's a discriminatory tax on its
13 face. It is the kind of tax that I think it's fair to say the
14 framers were concerned about right from the beginning.

15 QUESTION: Well, I guess it's a little hard though to
16 distinguish between an outright grant of state money and an
17 extension of a tax credit?

18 MR. SCHWARTZ: Right. It is, Your Honor, but that
19 kind of distinction is a distinction that this Court has always
20 made, and frequently made, because ultimately almost everything
21 that a State does when it spends money, whether it spends money
22 on research, whether it spends money to facilitate matters in
23 one way or another for its products, is an expenditure of money
24 on behalf of its own.

25 For example, in the Hunt case, the Court pointed out

1 -- and I think that was unanimous -- that the State of
2 Washington had spent a great deal of money to develop a grading
3 system for Washington apples. And when North Carolina tried to
4 match that by taking away that advantage that the State of
5 Washington had created, this Court unanimously said, you can't
6 do that. It's okay to spend money.

7 But when you discriminate, when you set up a tax
8 system and it is discriminatory taxes that the Commerce Clause
9 is historically aimed at, when you set, and which this Court
10 has again and again struck down --

11 QUESTION: So you would just distinguish the
12 Alexandria Scrap type situation based on the fact that this is
13 within the tax structure?

14 MR. SCHWARTZ: That's right. And the Court did so
15 itself, Your Honor. In Alexandria Scrap and in the cases
16 subsequent to Alexandria Scrap, Reeves, the others,
17 particularly in Justice Blackmun's discussion in Reeves of the
18 market participant doctrine, the Court said, the Commerce
19 Clause is aimed at regulation and direct taxes. It is not
20 aimed at the situation where a state enters the market. It is
21 not aimed at the situation where perhaps the State even spends
22 its own money.

23 QUESTION: Mr. Schwartz, I'm not sure you'd really
24 hold to that line.

25 In the subsidy situation you were just addressing,

1 it's assumed that the subsidy goes to the producer, no matter
2 where the producer sells it. Suppose you had a state subsidy
3 that applied to an in-state producer but only if he sells those
4 products within the state, and he forgoes that subsidy to the
5 extent he ships out of the state, would you say, well, that's
6 not a tax so it's all right?

7 MR. SCHWARTZ: Yes, Your Honor, I would say that.

8 QUESTION: You would.

9 MR. SCHWARTZ: Because it is not a tax. I think --

10 QUESTION: As long as it's not a tax, you can do
11 whatever you like to --

12 MR. SCHWARTZ: Well, you can spend your money in any
13 way you want so long as you're not taxing. You can spend money
14 on anything you want in your own state.

15 QUESTION: So I can subsidize an in-state produce but
16 only if he ships nothing out of state and as soon as he ships
17 out of state, he loses the subsidy and that doesn't interfere
18 with the Commerce Clause?

19 MR. SCHWARTZ: Well, I think that's right because I
20 think at that point, it comes close to the market participant
21 doctrine although there is a danger that that doctrine could
22 swallow up the entire situation.

23 In the tax area again and again, Your Honor, and I
24 think you would referred to this yourself last year in the
25 Scheiner case, things would seem the same which have the same

1 effect will nevertheless produce different kinds of results.
2 We are dealing here, as I think the Court said in, I think
3 Justice Holmes said it in Towne against Eisner where a page of
4 history is worth a page of logic.

5 QUESTION: A volume --

6 QUESTION: A volume of logic.

7 MR. SCHWARTZ: Pardon?

8 QUESTION: A volume of logic.

9 MR. SCHWARTZ: I stand corrected. A volume of logic.
10 In fact, it's much better. The point is lost in my version and
11 it's reinforced in yours.

12 It seems to me that this is precisely what we're
13 dealing with here. States can spend their own money. They can
14 do it in the manner they choose. But the tax structure has so
15 many possibilities of discrimination built into it, and it's
16 historically so dangerous because the alternative, Justice
17 O'Connor, I think would be to have to repudiate a line of cases
18 that goes back to Welton against Missouri in which states again
19 and again have said, we are trying to help our local industry.

20 The Hawaiian case just a few years ago, they said
21 here is this struggling little brandy, Okolehau brandy -- to an
22 easterner, that's a little hard to pronounce, this little
23 product which has almost no market, and then there's this
24 pineapple wine which has no market at all. And we will give
25 them a tax exemption from the twenty percent tax that we've

1 established.

2 The Court said -- and on this point, I think there
3 was no dissent -- I think there was a dissent on the
4 implications of the 21st amendment, on this point the Court
5 said, you just can't do that. You can't help your own industry
6 by a discriminatory tax.

7 Now, if I may take a minute to sort of recollect
8 where I was in my argument.

9 Now, to go back, some ethanol was sold in Ohio in
10 1979 and 1980, but in 1981, the same year New Energy's Ohio
11 competitor, Southpoint Ethanol, which is an intervenor in this
12 case, was formed, Ohio adopted a sales tax credit for all
13 ethanol sold in Ohio. It was about 3.5 cents a gallon of
14 gasohol, which ultimately fell to 2.5 cents.

15 Indiana had a comparable fuel tax credit which it
16 repealed in early '84, effective July, '85, and it authorized
17 at that time a production subsidy which in fact was dropped a
18 year later again on July '86.

19 In the fall of 1984, New Energy went into production
20 in Indiana. And Southpoint's sales in Indiana began to fall
21 sharply. On December 20th, the Ohio reciprocity provision was
22 enacted. As the Trial Court found, Southpoint had lobbied the
23 Ohio legislature for this provision, in fact, stressing to the
24 legislature -- and the word stressing was used twice by the
25 Southpoint witness -- how important Southpoint was to the most

1 depressed areas of the Ohio economy.

2 This reciprocity provision which also, by the way,
3 excluded ethanol from almost all gas-fired plants and ethanol
4 made from cane and beet sugar, this was done in order to
5 pressure Indiana to restore the Indiana tax credit, and in fact
6 it was aimed only at Indiana, for every other state that could
7 be affected by this tax credit, the producers in other states
8 like Tennessee, Illinois and elsewhere already had a credit
9 which they were giving.

10 Now, loss of the Ohio tax credit, when all of the New
11 Energy's competitors continued to get this credit inevitably
12 excluded New Energy from the Ohio market, as the Trial Court
13 found. When New Energy challenged this Statute, the Trial
14 Court found two, and only two legislative purposes. And I'd
15 like to quote that, if I may.

16 "To promote domestic industry and to affect the
17 policies of other states."

18 The Court nevertheless upheld the statute because --

19 QUESTION: May I stop you on that point just for a
20 moment.

21 The Court did also adopt appellees' additional
22 finding of purpose.

23 MR. SCHWARTZ: Right, Your Honor.

24 QUESTION: And it isn't altogether clear to me
25 whether or not there was an additional purpose to provide a

1 cleaner and safer environment for Ohio citizens.

2 MR. SCHWARTZ: Your Honor, that's a troubling point.
3 I had a lot of trouble understanding that finding.

4 The first sentence says, it is conceivable that there
5 were other purposes. One of these was -- now if conceivable
6 modifies everything which is actually all there is, then it
7 seems to me there is no such finding. And indeed when one
8 looks at the intermediate appellate court's opinion, which
9 lists the purposes, it does not include that.

10 QUESTION: If it was a purpose of the legislature,
11 how does that affect the legal analysis?

12 MR. SCHWARTZ: Not at all, Your Honor, because if it
13 were, there would still be a least drastic alternative test.
14 After all, in Dean Milk and many other cases, the Court said,
15 and in Hunt, for example, the Court said we accept that this is
16 a legitimate bona fide purpose. However, you have to apply the
17 least drastic alternative.

18 And in this case, I planned to get to it shortly, but
19 I could get to it right now, there is just no question that
20 this is not the least drastic alternative. How in the world do
21 you increase the amount of ethanol by excluding ethanol just
22 because it comes from a state that uses a different incentive,
23 because it comes from a coal-fired plant, because it is made of
24 cane or beet sugar. Indeed, it's counterproductive to that
25 because New Energy's loss of the market may have gone to

1 gasoline, not to gasohol, in which case the amount of pollution
2 in the air would multiply rather than be reduced.

3 Now, despite these findings which, again with the
4 ambiguity that you've pointed to, the Court nevertheless upheld
5 the statute because New Energy was the only producer affected
6 and would not have been affected had Indiana not repealed the
7 tax credit.

8 QUESTION: Do we have cases which say that it's
9 improper to try to influence the policies of other states'?

10 MR. SCHWARTZ: Yes, there are, but of course, it
11 depends on the method of influence. There is nothing wrong
12 inherently in trying to influence the policies of other states.
13 It depends on how you do it. Indeed, even under the equal
14 protection clause where that is an even more acceptable purpose
15 in the Metropolitan Life case, the Court said, you can try to
16 influence other states, but you can't do it by discriminating
17 in taxes.

18 So that it seems to me the answer is in itself
19 neutrally there's no problem about trying to influence. If for
20 example, you try to influence by improving the economic climate
21 say by I suppose a right to work law or some other kind of
22 economic or friendly regulatory climate, other states obviously
23 may try to respond in other ways.

24 QUESTION: So the objective itself is legitimate to
25 try to influence the policy of other states?

1 MR. SCHWARTZ: That objective, yes, Your Honor, yes.
2 To influence is correct, but it depends on how you do it.

3 QUESTION: What if Ohio felt that coal-fired energy
4 plants in Indiana to the west of it were producing a lot of
5 acid rain in Indiana. Could it instruct or regulate its
6 utilities to tell them they couldn't buy from any coal-fired
7 plant in Indiana?

8 MR. SCHWARTZ: If that were the least drastic way of
9 dealing with that very serious health problem, the answer would
10 be, yes.

11 QUESTION: What's the leading case that you can think
12 of that applies the least drastic alternative test in this
13 situation?

14 MR. SCHWARTZ: Well, I'm not quite sure by, this
15 situation, but the cases I rely on are Dean Milk.

16 QUESTION: Did that use the term, least drastic?

17 MR. SCHWARTZ: Yes. Yes, it did, Your Honor. I'm
18 quite sure that it did use the term. And I think the A&P case
19 did as well.

20 QUESTION: I thought Dean used the reasonable
21 alternative analysis, it said whether there's a reasonable
22 alternative.

23 MR. SCHWARTZ: I don't think so, Your Honor, because
24 I think as I recall Justice Black was unhappy because it was
25 using First Amendment doctrine, and I think he commented on

1 that. I'm not sure.

2 I think the phrase in A&P there's one reference here
3 to less drastic alternative, and there are I think other ways
4 in which the Court stressed that you've got to look at other
5 alternatives that create less problems.

6 Indeed, the Pike v. Bruce Church test itself says
7 that even when something regulates evenhandedly, which I think
8 this does not, even when something regulates evenhandedly under
9 those circumstances, and for a legitimate purpose, you still
10 have to look to see where there are other ways that could
11 accomplish the same thing.

12 QUESTION: But, Mr. Schwartz, it's one thing to say
13 you have to look at other alternatives.

14 MR. SCHWARTZ: Right.

15 QUESTION: It's quite another thing to say you must
16 employ the least drastic of these alternatives.

17 MR. SCHWARTZ: Well, Your Honor, even if it's not
18 least drastic, the Court certainly has insisted on less
19 burdensome, and there are less burdensome. Indeed, the initial
20 statute, the initial tax credit in Ohio in 1981 which allowed
21 the credit for ethanol, just like that, ethanol or methanol
22 itself was quite an adequate alternative without the
23 reciprocity.

24 We are not challenging the tax credit which was made
25 available in '81 to everyone. We're challenging the

1 reciprocity and we're saying that the tax credit without the
2 reciprocity which now some eleven states have and which in 1985
3 approximately 23 states had, that that is a less burdensome
4 alternative which accomplishes the same purpose.

5 After all, over the years, the rate of usage of
6 ethanol, of gasohol, I think, has risen from something like 400
7 or 500 million gallons to 900 million gallons during this
8 period without, with very few of these reciprocity statutes
9 operating.

10 Now, if I may return, our argument, which is of
11 course what we've been talking about here is that reciprocity
12 statutes face strict scrutiny and for a very good reason. They
13 involve facial discrimination, they create most favored nation
14 enclaves, precisely the kind of preferential trade areas that
15 the Commerce Clause is supposed to prevent, and they threaten
16 economic isolation in an effort to control the policies of
17 other states.

18 All of those I think have been touched on by this
19 Court. Now, the Ohio courts recognized the applicability of
20 strict scrutiny, but they ruled that because others from
21 outside Ohio, besides New Energy, could come into Ohio, there
22 was no violation. Now, that logic this Court has never
23 adopted.

24 In some cases for example that this Court has dealt
25 with, only one out-of-state company was involved. That's true

1 of the Pike case, it's true of Lewis against Bete Investment.
2 In A&P, for example, many other states, I think it was
3 something like eight states, had reciprocity agreements with
4 Mississippi. Louisiana did not. And the Court still struck
5 that down unanimously.

6 There is no requirement either that there be an
7 absolute bar. I think this Court has recognized right from the
8 beginning that taxes can have the same effect as an absolute
9 bar, and in fact in this case as the Trial Court recognized, it
10 had precisely that effect. New Energy was excluded.

11 The fact is with the competitors getting the credit,
12 there was no way New Energy could compete in the Ohio market.

13 Now, with respect to the health claim, I think I've
14 already touched on that, unless there are some further
15 questions on it.

16 And indeed, there's some question as to whether any
17 credit is necessary for health, because over the years, there
18 has been a decline in the use of any tax credits and an
19 enormous increase in the use of ethanol. And as I pointed out
20 before, it's very possible that New Energy's loss in Indiana
21 may have been diverted not to another ethanol producer, but to
22 gasoline, which in turn would produce increased pollution.

23 And I think the record quite beyond dispute shows
24 that the purpose here was to pressure Indiana to restore that
25 tax credit for the benefit of the Ohio competitor, an important

1 employer in perhaps the most depressed area of the State that
2 used a great deal of Ohio corn and coal. And as I said, this
3 was stressed at the legislative hearing.

4 Now, an argument has been made --

5 QUESTION: Mr. Schwartz, before you go on to the new
6 argument, will you tell me why this is different from what we
7 have clearly allowed that is facially discriminatory and that
8 is the assessment by a state of a compensating use tax.

9 In that situation, the state is just equilibrating
10 matters between itself and other states. It's worried that its
11 sellers will be at a disadvantage because of its tax if other
12 states don't impose taxes so it imposes a use tax on any
13 imports. It seems to me the state here is doing the same
14 thing. It's worried that its sellers will be at a disadvantage
15 abroad, viz a viz, the sellers in the state that does not give
16 the same credit that it does. So it's just making things even.

17 MR. SCHWARTZ: Your Honor, I think the difference is,
18 and the case you're talking about is obviously Henneford v.
19 Silas Mason, that line of case.

20 QUESTION: Right. And they're tax cases.

21 MR. SCHWARTZ: Right. Oh, yes, they're clearly tax
22 cases.

23 The difference is that that's a situation in which a
24 state itself has imposed a tax burden on its own people, and it
25 says that we don't want to hurt our own people too much so

1 therefore we will equalize matters by saying that if you buy
2 something outside and use it here, our people will not be at a
3 disadvantage. But it's a disadvantage that the state itself
4 created.

5 In this case, there was no disadvantage when the tax
6 credit went to everyone, and indeed there was no disadvantage
7 had there been no tax credit at all. Ohio created a
8 disadvantage whereas in the Silas Henneford Mason (sic) case by
9 the reference to other states, Ohio undid a disadvantage to its
10 people, or the State of Washington, actually, that the State of
11 Washington itself had created. And it was a straight
12 equalizer, penny for penny.

13 Whereas here, when there's an attempt to equalize
14 whatever advantages other states have, we have an attempt to
15 mix apples and pears. If for example another state provides
16 research help, here we're providing a discriminatory tax.
17 There's no way of knowing whether they are in any way equal.

18 Henneford Silas Mason (sic) it was calibrated exactly
19 to the penny and as I think it was Justice Cardozo who said it,
20 equality is the hallmark. Not true here. This statute does
21 not create equality.

22 Now, I have just a couple of minutes more before the
23 close of my argument, and I'd like to respond briefly if I may
24 make a couple of points with respect to as I say Justice
25 O'Connor's raising before of this issue of bounties and

1 subsidies and market participant.

2 The market participant is a narrow doctrine designed
3 to deal with that situation whereas the Court has said, and I
4 think the most detailed statement is in Reeves and I think
5 other Justices have quoted that Reeves statement, where the
6 State acts as the equivalent of a private business, where it is
7 buying or it is selling or it is manufacturing.

8 QUESTION: Well, that doesn't explain Alexandria
9 Scrap, I don't think.

10 MR. SCHWARTZ: It doesn't explain it fully except
11 Justice Powell referred to the case as, I think the Reeves case
12 as a situation in which the State was really acting as a
13 purchaser.

14 What happened in Alexandria Scrap, of course, --

15 QUESTION: Well, I don't think so. The situation
16 appears at least to be one where the state wanted to encourage
17 disposal of the old auto hulks, just like Ohio might want to
18 encourage the use of ethanol.

19 MR. SCHWARTZ: Yes. But the Court, I think, has
20 characterized it, and indeed in the subsequent cases certainly
21 treated both Alexandria Scrap and the line of cases as a line
22 of cases where the state acts as a private trader. Indeed, the
23 justification I think that was given in Reeves v. Stake is that
24 it acts as a private trader and may indeed even be subject to
25 the constraints of a private trader, which a plurality of the

1 Court then applied subsequently in the South Central Timber
2 case, imposing restraints on an alienation and in effect
3 preventing an effort to control a downstream operation, namely,
4 processing of timber.

5 And unless I think the rule is cabined and limited
6 that way, it could easily swallow up the entire Commerce
7 Clause, because again almost any tax credit can be called a tax
8 expenditure. And indeed an expenditure. And at that point,
9 the Court would have to reexamine and in effect overrule this
10 lengthy line of cases which go as recently as last year.

11 I think I will sit down now and reserve the rest of
12 my time for rebuttal. And simply conclude by saying that this
13 Statute is clearly unconstitutional under the Commerce Clause
14 and the decision of the Supreme Court of Ohio on rehearing the
15 second Ohio Supreme Court decision should be overruled and
16 reversed.

17 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Schwartz.
18 Mr. Farrin, we'll hear now from you.

19 ORAL ARGUMENT OF RICHARD C. FARRIN, ESQUIRE

20 ON BEHALF OF THE APPELLEES

21 MR. FARRIN: Mr. Chief Justice and may it please the
22 Court.

23 The issues in this case are twofold. The first issue
24 to be decided is whether the Ohio tax credit scheme is the type
25 of state action that is subject to the restraints of the

1 Commerce Clause. Within this one issue there are actually two
2 questions to be considered by the Court.

3 Initially as this Court has heard during the initial
4 argument in this case, whether or not the market participant
5 principle applies to the ethanol tax credit scheme.

6 The second issue, which is also a matter that was
7 touched upon by this Court in the Alexandria Scrap case but not
8 decided, is whether the Commerce Clause prohibits state action
9 effecting a flow of commerce that is dependent for its
10 existence upon a state subsidy rather than on the private
11 market.

12 The second issue is whether assuming this scheme is
13 subject to the Commerce Clause restrictions, whether it is
14 valid under the various tests established by this Court.

15 As New Energy's counsel has pointed out, the Ohio
16 General Assembly initially enacted its tax credit provision in
17 1981 to provide an encouragement for the use of ethanol as a
18 substitute for lead in gasoline. The result of this use would
19 be to protect the environment of Ohio because as has been
20 stipulated throughout these proceedings, ethanol is the most
21 environmentally benign substitute for lead in gasoline.

22 Other benefits of the use of ethanol are the creation
23 of an alternative market for corn and a reduction of the
24 country's dependency on foreign oil. It's undisputed that
25 these purposes are legitimate purposes for the State to pursue.

1 The portion of the scheme that is the subject of the
2 challenge before this Court is the enactment in 1984 which
3 became effective in 1985 of the reciprocity provision that
4 limited the credit given to motor vehicle fuel dealers to the
5 use of ethanol that was produced either in Ohio or in any other
6 state that granted similar credits for the use of ethanol to
7 Ohio dealers to Ohio produced ethanol.

8 This scheme, including the reciprocity scheme, does
9 not put any prohibition on the sale or distribution of ethanol
10 in Ohio, nor does it regulate the conditions under which the
11 flow of ethanol may occur in Ohio. By this scheme, Ohio has
12 simply entered the market by providing a subsidy to build up
13 the price of ethanol. This subsidy is necessary in order for
14 ethanol to compete with gasoline in the marketplace.

15 QUESTION: When under your view of it did Ohio enter
16 the market, in 1981 or 1984?

17 MR. FARRIN: Justice Stevens, I believe Ohio entered
18 the market initially when it first enacted the credit provision
19 1981. Its purpose at that point in time was the same, to bid
20 up the price of ethanol so that it might compete with gasoline
21 in the marketplace. Because of the production costs involved
22 with ethanol, absent both Federal and state subsidies, ethanol
23 simply could not compete in the free private marketplace with
24 gasoline. And the evidence in the record affirms that fact.

25 QUESTION: Mr. Farrin, do you really think it solves

1 matters to simply say it's the application of a state subsidy?
2 I assume, for example, that a state could if it chooses
3 subsidize all of its domestic industries in a lot of ways, by
4 tax credits, or even by giving them money. But do you think a
5 state could subsidize domestic production by only charging a
6 sales tax on out-of-state products and not charging a sales tax
7 on in-state products. And saying, well, that's all fine
8 because all we're doing is subsidizing in-state industry which
9 is certainly a laudable and valid goal?

10 MR. FARRIN: Justice Scalia, initially I think from
11 an economic standpoint, that's a very unlikely event.
12 Secondly, I don't think this case requires the Court to so
13 hold.

14 QUESTION: I didn't ask either of those questions.
15 I asked whether you thought that would be
16 constitutional simply because it's the application of a state
17 subsidy?

18 MR. FARRIN: I do not think it would be to simply use
19 a tax exemption to favor local business with no other purpose,
20 I do not believe would be constitutional, Justice Scalia.

21 QUESTION: So subsidy isn't the answer. I mean, it
22 doesn't necessarily prove that this is okay.

23 MR. FARRIN: Your Honor, I submit under Alexandria
24 Scrap that a direct subsidy may in fact be unlimited. I think
25 that case leaves the future unclear as to how it will be

1 applied as it goes along the spectrum to the point that's
2 suggested in your question.

3 I submit though that at the least, Alexandria Scrap
4 would allow a state to subsidize a local industry if it was
5 part of a scheme that was effected to carry out a legitimate
6 state purpose other than simply protectionism. In Alexandria
7 Scrap, the purpose of the statute was to effect the removal of
8 abandoned hulks in the state.

9 In this case, the primary purpose of the ethanol
10 credit scheme is not solely to benefit Ohio business. Its
11 purpose is to encourage the use of ethanol which will have
12 great environmental benefits in the State of Ohio, plus it will
13 have other benefits including the increased market for corn and
14 reduction on the dependency of foreign oil.

15 QUESTION: Well, it's purpose is to insist that other
16 states do it Ohio's way, isn't it?

17 MR. FARRIN: Justice Kennedy, I was speaking of the
18 scheme as a whole, and I think that's what Alexandria Scrap
19 looked at, the scheme as a whole was intended to further a
20 legitimate state purpose. One aspect of the scheme --

21 QUESTION: But it did so in a way that penalized
22 producers from one state and not others, and incidentally
23 helped Ohio producers.

24 MR. FARRIN: Justice Kennedy, I don't think the
25 record indicates whether or not it did help Ohio producers or

1 whether it was intended to help Ohio producers viz a viz their
2 foreign competitors.

3 QUESTION: Well, it didn't hurt Ohio producers, did
4 it?

5 MR. FARRIN: I would be amazed if it hurt Ohio
6 producers, Justice Kennedy. But I think if you look at
7 Alexandria Scrap, the same exact situation was present there.
8 Maryland first enacted their scheme which provided subsidies to
9 scrap processors. There's no difference in the --

10 QUESTION: Well, there, the State was actually buying
11 the hulks.

12 Are you saying the State enters the market any time
13 it imposes a tax?

14 MR. FARRIN: Justice Kennedy, I don't believe that
15 the State of Maryland was purchasing hulks in the Alexandria
16 Scrap. They were simply giving subsidies to processors who
17 bought hulks. In this case, Ohio is giving subsidies to motor
18 vehicle fuel dealers who buy ethanol and use it in creating
19 gasohol.

20 QUESTION: Well, it's giving a tax credit which has
21 the same economic effect as a subsidy, isn't that right?

22 MR. FARRIN: Justice O'Connor, that's correct, it's a
23 tax credit, but I submit that it would be extremely formalistic
24 to suggest that it is different in form.

25 QUESTION: Well, have we ever applied the market

1 participant theory to a tax scheme in a state?

2 MR. FARRIN: No, Justice O'Connor, this Court has
3 not.

4 QUESTION: Yes, but isn't there a difference in
5 Alexandria Scrap the hulks that they wanted to get rid of were
6 all located in Maryland, weren't they? The procedure generally
7 was to get rid of these hulks that were in the State? And it
8 didn't really matter whether it was an out-of-state wrecking
9 company or an in-state wrecking company that bought them as
10 long as the hulk was in Maryland.

11 But here your interest is in having the gasohol that
12 is consumed in Ohio be less contaminated than regular gas, and
13 it is immaterial where the gas comes from as long as you have
14 an environmental interest. You'd get the same benefit if
15 Indiana gasohol were used in Ohio.

16 MR. FARRIN: Justice Stevens, the reason why Ohio is
17 attempting to encourage other states to pass similar credits is
18 so that ethanol will be used in those states.

19 QUESTION: But what does Ohio care about whether
20 ethanol's used in those states. If the ethanol produced in
21 those states is consumed on Ohio, that's what Ohio cares about,
22 isn't it?

23 MR. FARRIN: Justice Stevens, I think Ohio is also
24 legitimately concerned in the clean air of other states.

25 QUESTION: In Indiana? They're concerned about the

1 clean air in Indiana?

2 MR. FARRIN: Justice Stevens, that air comes into
3 Ohio. I don't think the environment can stop at the state
4 lines. When you're interested in cleaning up polluted air, you
5 can't say if we just use it in Ohio, our air will be clean.

6 QUESTION: Is there anything in the legislative
7 history to support this theory?

8 MR. FARRIN: There's simply no legislative history in
9 this matter.

10 QUESTION: Is there anything in our precedents which
11 says that one state can take action to influence the conduct
12 and the policies of other states? I thought that's what the
13 Commerce Clause was all about.

14 MR. FARRIN: Justice Kennedy, I don't believe there
15 are any decisions of this Court that suggest a state cannot
16 encourage other states to act. We're simply encouraging the
17 other states to pass similar credits so that there'll be a
18 national market for ethanol.

19 Another point in response to Justice Stevens'
20 question is that the nature of the ethanol industry is such
21 that it can't exist if there are simply a few states which
22 allow credits so that it can compete with gasoline. In those
23 states in which no credits are given, the ethanol industry will
24 not exist because it can't compete in the private marketplace
25 with gasoline.

1 QUESTION: You seriously think the '84 amendment
2 actually would encourage industry as a whole rather than
3 discourage it?

4 MR. FARRIN: Yes, I do, Justice Stevens.

5 QUESTION: It certainly wouldn't help it any in
6 Indiana.

7 MR. FARRIN: It would help the industry greatly if
8 Indiana took the encouragement of Ohio and passed some type of
9 a credit for ethanol.

10 QUESTION: Well, maybe Indiana has a better way of
11 doing it. What if every state were to adopt the Indiana
12 program of subsidizing the industry?

13 MR. FARRIN: Justice Stevens, I --

14 QUESTION: Why is one better than the other?

15 MR. FARRIN: I don't submit that one might be better
16 than the other, but I do submit that it would have no
17 difference in effect. I don't think there's any reason to
18 distinguish a straight subsidy program, such as in Alexandria
19 Scrap from doing the same thing through the granting of tax
20 credits.

21 QUESTION: Well, what do you say to your opponent's
22 argument that maybe the Indiana gasohol that no longer comes
23 into Ohio has been replaced by lead gas rather than gasohol?

24 MR. FARRIN: Justice Stevens, --

25 QUESTION: That's possible.

1 MR. FARRIN: -- I would first say that there's
2 nothing at all in the record to suggest that. I would submit
3 that the greater assumption, and the assumption that the Ohio
4 Court of Appeals made on what evidence there was in the record
5 was that it would be replaced from ethanol produced in other
6 states which do have such ethanol credits. The evidence
7 indicated that the largest and most aggressive producer of
8 ethanol in the country was Archer Daniel Midland out of
9 Illinois and they have the ability to fully fill any void in
10 the market that might be left by New Energy's leaving that
11 market.

12 QUESTION: General Farrin, do these subsidy laws tend
13 to predominate in those states that have a lot of air or those
14 states that have a lot of corn? I mean, do you really think
15 that that's what's going on here?

16 MR. FARRIN: Justice Scalia, if you're referring
17 simply to a subsidy provision such as the one that Indiana had
18 at one time, I'm not aware that there are any, if many, of
19 those types of provisions. Most of the states that I'm aware
20 of have addressed this problem through their tax system.

21 QUESTION: They are corn growing, aren't they?

22 MR. FARRIN: Justice Scalia, I'm not an expert on
23 agriculture, but it would not surprise me that those states
24 that have large corn surpluses would find that also to be an
25 additional reason for encouraging the use of ethanol, because

1 clearly the more ethanol that is used, the more corn, which is
2 a primary raw material, is used.

3 I would point out that there is no restriction
4 whatsoever in the Ohio statutory scheme that limits the source
5 of the corn used to make ethanol. And in fact, the record
6 reveals that one Ohio producer used as much Indiana corn as
7 Ohio corn in producing it.

8 QUESTION: There is a national market in corn, of
9 course. You can take it from anywhere and the national
10 market's going to help your domestic corn.

11 MR. FARRIN: That's correct, Justice Scalia. And I
12 suggest the same reasons point to the necessity for having a
13 national market in ethanol. It's simply a matter of things
14 such as economies of scale. If a producer is going to be
15 limited to the market it can distribute its product, it's
16 simply not going to get to the level where it can compete with
17 the major gas producers of the country.

18 The Ohio scheme has not caused any impact on the flow
19 of ethanol from Indiana due to any prohibition or to any
20 regulation on the way or method by which it can come into Ohio.
21 The impact on the flow if any ethanol from New Energy is due to
22 Ohio making it more lucrative for Ohio motor vehicle fuelers to
23 use that fuel because they get a credit if they use fuel that's
24 produced in Ohio or in any other state that grants a similar
25 credit.

1 This is not the type of State action which this Court
2 has ever held the Commerce Clause was intended to prohibit. In
3 fact, it does not interfere with the private market forces. It
4 simply exerts a market force to encourage or give an incentive
5 to motor vehicle fuel dealers upon whom the tax is applied and
6 to whom the credit is given.

7 QUESTION: General Farrin, how do you distinguish the
8 Hawaiian tax case on these exotic beverages they had over
9 there, the tax credit for those local --

10 MR. FARRIN: Justice Stevens, perhaps the major
11 distinction is that there was no purpose other than simply to
12 protect local industry in that case. In this situation, I
13 submit that the record demonstrates that there is a legitimate
14 purpose for the statutory scheme involved.

15 QUESTION: And that purpose is the health and
16 environment purpose?

17 MR. FARRIN: I believe it's the health environment
18 purpose. I think it's also the resulting effects that
19 encouragement of ethanol has on the corn market and in our
20 attempts to reduce our dependency on foreign oil.

21 And I would point out that's another reason why we
22 allow an exemption for coal-fired plants, rather than gas-fired
23 plants because we're looking for alternative sources of energy.
24 One of the fast depleting sources is gas. If we allow the
25 credit for plants that use gas, it simply defeats the purpose.

1 QUESTION: Well, has the Court required a close fit,
2 even if the purpose is legitimate? In other words, does the
3 scheme have to fit very closely to that legitimate purpose?
4 And does this kind of reciprocity provision meet that kind of
5 requirement?

6 MR. FARRIN: Justice O'Connor, I don't think this
7 Court has ever stated that you actually need an alternative
8 purpose other than to protect the local businesses. In
9 Alexandria Scrap, it seemed to be accepted by the Court that
10 the amendment that resulted in favoring Maryland processors and
11 in reducing the flow of hulks into Maryland was done for the
12 purpose of protecting Maryland processors.

13 QUESTION: But that was because Maryland created a
14 market that had not previously existed.

15 And this is a market that exists quite without regard
16 to the intervention of the State of Ohio.

17 MR. FARRIN: Justice Kennedy, the majority in
18 Alexandria Scrap found that the record in that case did not
19 establish that the market in that scrap processing did not
20 exist. Justice Stevens in his concurring opinion so found but
21 the majority found that the record simply wasn't sufficient.

22 I would suggest in this case the record is replete
23 with evidence that shows that the ethanol market in Ohio would
24 not exist without the State subsidy. It simply could not
25 compete with gasoline in the naturally functioning market

1 without the state subsidy.

2 QUESTION: Well, how about gasohol from other States?

3 MR. FARRIN: Justice White, gasohol or ethanol from
4 other States cannot compete with gasoline either without
5 subsidies, and again, that goes back to what I submit is one of
6 the purposes of the reciprocity provision. We're looking to
7 have a national market which we believe is essential for the
8 future of the ethanol industry. If all the states, or if a
9 number of the states choose not to provide ethanol credits, the
10 ethanol industry will not survive, at least at no significant
11 level in those states.

12 QUESTION: Well, how does keeping out a seller from
13 another state that doesn't grant reciprocity, that doesn't
14 grant Ohio people a credit there, how does keeping them out
15 serve the health's interest of Ohio?

16 MR. FARRIN: Justice White, it's because of the
17 method by which that encouragement is taken. We are
18 encouraging those states to enact similar credits so that
19 ethanol will be used in those states and so that there will be
20 a national market for ethanol which will be beneficial to the
21 entire industry.

22 QUESTION: Well, here's an outsider that wants to,
23 that apparently has enough product to sell in Ohio. And if he
24 can't come in, why his share of the market's going to be taken
25 up by another ethanol producer, either an Ohio one or a foreign

1 one, or by gasoline.

2 MR. FARRIN: That's correct, Justice White. I don't
3 think it will affect --

4 QUESTION: Well, what difference does it make where
5 the ethanol comes from?

6 MR. FARRIN: For the purposes of --

7 QUESTION: Looks to me like the more sellers of
8 ethanol you've got in Ohio, the more service to your health's
9 interest you'd have.

10 MR. FARRIN: Justice White, that goes part of the
11 way, I believe.

12 And I think to follow out that thought, the more
13 ethanol use you have in the country, it even further advances
14 that purpose. And that is the purpose of the reciprocity.
15 It's not simply to keep out -- it's not because Indiana ethanol
16 is any less effective. It's to encourage Indiana and other
17 states to grant ethanol credits so that the national ethanol
18 market will grow and so that all states will use the
19 environmentally benign product so that the environment of the
20 nation, which will affect all Ohio citizens plus citizens of
21 the nation will be benefitted.

22 Along the lines of the questioning as to where this
23 Court is going with the market participant theory, I think
24 perhaps a comment in a footnote of the Reeves case by the
25 majority points out where the limits might ultimately be.

1 In footnote 10, the Court noted that marketplace
2 actions involving integral operations in traditional areas of
3 governmental functions may not be subject even to Congressional
4 regulation pursuant to the commerce power. And it went on to
5 state that it follows easily that the intrinsic limits of the
6 Commerce Clause do not prohibit state marketplace conduct if it
7 falls within this sphere.

8 To me that suggests that what the Court is thinking
9 is that if you're dealing with a legitimate state purpose in
10 your overall statutory scheme, you are not subject to the
11 Commerce Clause. If you are not subject to the Commerce
12 Clause, it doesn't make any difference whether or not portions
13 of that scheme may have an effect on the flow of commerce.

14 QUESTION: If you state it that broadly, I guess the
15 Dean Milk case was incorrectly decided. Because there
16 certainly was a legitimate health purpose in their regulation.

17 MR. FARRIN: Justice Stevens, perhaps the
18 distinguishing fact in Dean Milk was that it in effect barred,
19 completely barred a product from coming into a marketplace
20 unless it complied with the statute. In this case, there is no
21 bar to ethanol coming into Ohio from any State. Any producer
22 may sell its ethanol in Ohio if it can sell it in the
23 marketplace.

24 QUESTION: How much Indiana ethanol is sold in Ohio
25 when you have this particular situation? There isn't any, is

1 there?

2 MR. FARRIN: Justice Stevens, the record doesn't
3 indicate it because this case was filed before the statute went
4 into effect, but I would not dispute that it is very likely
5 that they sell little or no ethanol.

6 QUESTION: None at all. It's the equivalent of an
7 absolute bar.

8 MR. FARRIN: Justice Stevens, I think it's different.
9 I think there's a difference between a statute intended to
10 encourage something that puts an economic incentive --

11 QUESTION: Well, but maybe Madison, Wisconsin,
12 because if we really want to encourage everybody else in the
13 country to have the same strict health regulations we have,
14 too, the best way to do it is to have everybody adopt this kind
15 of protectionist ordinance that no milk can be shipped --

16 MR. FARRIN: Justice Stevens, if in Dean Milk, the
17 ordinance said, you will do it within five miles of the city, I
18 believe, or in a plant in another area which has the same
19 requirements, I think that would have passed the Constitutional
20 test. I think that's what Ohio does. It says, you shall use
21 Ohio ethanol or you shall use ethanol which is produced in a
22 state which has similar credits.

23 QUESTION: Not other ethanol, but meets the same
24 physical requirements and health standards and all the rest but
25 just that it's produced in states that adopt the same public

1 policies of how to subsidize the industry that we think are the
2 wisest.

3 MR. FARRIN: That's correct, Justice Stevens, and I
4 think that's a matter for the legislature to determine as to
5 the wisdom of its course of action, and whether it believes it
6 will effect that result.

7 QUESTION: Well, Mr. Farrin, this Court so far has
8 invalidated all these reciprocity laws. It did so in Sporhase
9 v. Nebraska; it did it in A&P Tea Company; it did it in Baldwin
10 v. Seelig. Dean Milk. I mean, find some cases where we've
11 upheld this kind of a scheme.

12 MR. FARRIN: Justice O'Connor, I don't think in any
13 of those cases, this Court struck down a scheme such as the one
14 at issue here. In Great A&P Tea Company and in Sporhase, the
15 reciprocity provisions themselves were not the subject of a per
16 se rule of invalidity, it was the effect of those reciprocity
17 provisions which was to impose an absolute ban on the sale or
18 distribution or movement of a matter or a product in interstate
19 commerce.

20 I'd point out that in Great A&P Tea Company, this
21 Court also recognized that the purported purpose by the State
22 of Mississippi bordered on the frivolous. But in any event, I
23 would submit that what the cases stand for is that you cannot
24 impose an absolute ban on the movement of goods in commerce.

25 Neither of those cases, by the way, dealt with a tax

1 subsidy or a straight subsidy program.

2 QUESTION: I don't think the Court has distinguished
3 between an absolute ban and a substantial burden on interstate
4 commerce.

5 MR. FARRIN: Justice O'Connor, I believe this Court
6 has distinguished for purposes of determining which type of
7 Commerce Clause test to apply whether it subjected it to a
8 regular balancing test or whether it subjected it to a stricter
9 scrutiny test, such as was used in the A&P case. I would
10 submit that Baldwin was in fact not a reciprocity provision, to
11 my understanding. They simply precluded the movement of those
12 goods without any ability for other states to allow that
13 movement by granting reciprocity.

14 QUESTION: Do you think that Ohio could impose a
15 penny tax on all gasoline from states that don't subsidize
16 ethanol? I mean, if it's, you know, the national scheme is in
17 its interest, why does it have to limit its incentives to
18 ethanol? Why can't it start fiddling with other imports into
19 the state, subsidize some of them and tax others in order to
20 induce other states to subsidize ethanol?

21 Is there anything in the nature of your theory that
22 would require Ohio to limit itself to ethanol as a device to
23 get other states to go along?

24 MR. FARRIN: No, Justice Scalia, it would not be
25 limited to ethanol. I think --

1 QUESTION: That's scary, isn't it?

2 MR. FARRIN: I think what it would be limited to is
3 whether or not they had a legitimate purpose that was carried
4 out other than simply to protect their local businesses.

5 QUESTION: It would be the same purpose you have in
6 this case, to encourage other states to adopt this kind of an
7 ethanol policy.

8 MR. FARRIN: That's correct.

9 QUESTION: You could perhaps tax all imports from
10 Indiana unless Indiana adopted this type of tax credit.

11 MR. FARRIN: I assume I would believe that this Court
12 would not allow that broad a prohibition, of an absolute
13 prohibition.

14 QUESTION: No, I don't think it would, either, but I
15 think your theory would.

16 MR. FARRIN: The second issue that was discussed in
17 the Alexandria case, but was not decided because the majority
18 of the Court felt there was not an adequate record upon which
19 to determine it, was whether or not the Commerce Clause forbids
20 state action affecting a flow of commerce that is dependent for
21 its existence on state subsidies rather than on private market
22 forces.

23 The majority noted in a footnote that if the facts
24 had so shown, it would have hesitated to find that the Commerce
25 Clause did in fact prohibit such action. Concurring opinion by

1 Justice Stevens indicated that that Justice felt that the
2 Commerce Clause did not prohibit such state action.

3 I think the reasoning in both that footnote and in
4 Justice Stevens' concurring opinion supports that thought. The
5 Commerce Clause only prohibits state action which affects the
6 operation of a free market or a natural functioning of the
7 private marketplace. If there is no naturally functioning
8 private marketplace, how can any burden that is imposed upon
9 such a flow involve the Commerce Clause? It simply doesn't
10 interfere with a subject that the Commerce Clause was intended
11 to cover.

12 While the record in Alexandria Scrap might not have
13 been sufficient for the Court to determine that issue, the
14 record in this case is replete with evidence that the ethanol
15 market would not exist at its present level or at any
16 significant level in Ohio, absent the state credit that's
17 granted by this scheme.

18 Thank you, Your Honor.

19 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Farrin.

20 Mr. Schwartz, you have four minutes remaining.

21 ORAL ARGUMENT OF HERMAN SCHWARTZ, ESQ.

22 ON BEHALF OF THE APPELLANT - REBUTTAL

23 MR. SCHWARTZ: Your Honor, I am not going to take any
24 rebuttal time unless the Court has questions for me.

25 I will however confess with some embarrassment that

1 the thrust of the Chief Justice's question about least drastic
2 alternative was absolutely correct. The Court in Sporhase used
3 the phrase, narrowly tailored. And in some other cases, it has
4 referred to, less burdensome alternatives, but has not used
5 that particular phrase of less drastic alternative.

6 I don't have any doubt in my mind judging by the
7 questions and so on that the point has been made that that are
8 less burdensome alternatives, and that this was not narrowly
9 tailored. But I did want to make that clear, Your Honor, to
10 correct what was stated in my brief.

11 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Schwartz.

12 The case is submitted.

13 (Whereupon, at 11:38 a.m., the case in the above-
14 identified matter was submitted.)

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DOCKET NUMBER: 87-654

CASE TITLE: NEW ENERGY COMPANY OF INDIANA v. JOANNE LIMBACH

HEARING DATE: March 29, 1988

LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the SUPREME COURT OF THE UNITED STATES.

Date: March 29, 1988

Margaret Daly

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