THE FREE STATE FOUNDATION

A Free Market Think Tank for Maryland......Because Ideas Matter

Perspectives from FSF Scholars
May 21, 2019
Vol. 14, No. 14

State Net Neutrality Mandates and the Dormant Commerce Clause: Some Preliminary Thoughts

by

Daniel A. Lyons[*]

I. Introduction

The latest twist in the net neutrality debate has prompted a renewed interest in regulatory federalism. Opponents of the Federal Communication Commission's *Restoring Internet Freedom Order (RIF Order)*[1] have turned to state governors' mansions and legislatures, seeking to restore at the state level regulatory restrictions that the Commission repealed at the federal level. To date, six states have adopted executive orders[2] and four have passed statutes[3] that purport to impose net neutrality mandates on broadband providers.

Most commentary on state net neutrality has focused on whether the *RIF Order* preempts these state-level initiatives – an issue I addressed in an earlier FSF *Perspectives* article.[4] But there is a second, less-often discussed limitation on state power to regulate broadband network management practices: the Dormant Commerce Clause. The Dormant Commerce Clause doctrine prevents states from imposing undue burdens on interstate commerce. Previous courts have relied on this doctrine to limit state attempts to regulate online conduct. The Internet is a national (indeed, global) network, meaning that state attempts to regulate the flow of traffic on that network are likely to have extraterritorial effects that burden interstate commerce. As a

The Free State Foundation
P.O. Box 60680, Potomac, MD 20859
info@freestatefoundation.org
www.freestatefoundation.org

result, claims that these rules contravene the Dormant Commerce Clause could well prove a difficult obstacle for state attempts to resurrect net neutrality restrictions.

II. The Dormant Commerce Clause and Internet Regulation

The Dormant Commerce Clause prohibits states from enacting regulations that unduly burden interstate commerce. It is a judge-made doctrine, derived from the negative implication of the Constitution's grant to Congress of the power to regulate commerce between the states.[5] While states have general authority to regulate commerce within their footprints, they are (rightfully) beholden to their constituents, and therefore have incentives to adopt economic legislation that benefits parochial interests, even if it has a negative impact on non-residents and the national economy as a whole. The Dormant Commerce Clause doctrine operates as a check on this concern – the same concern that triggered the collapse of the Articles of Confederation and prompted the insertion of the Commerce Clause into the Constitution.

Because this dynamic can manifest itself in many ways, courts employ several tests to enforce the Dormant Commerce Clause doctrine. The "central rationale for the rule against discrimination is to prohibit state or municipal laws whose object is local economic protectionism."[6] Thus, state laws that explicitly discriminate against interstate commerce face "a virtually per se rule of invalidity."[7] But even a facially nondiscriminatory state law may nonetheless run afoul of the doctrine if it unduly burdens interstate commerce. Courts evaluate such claims under the test announced in *Pike v. Bruce Church*: "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[8]

The *Pike* balancing test played an important role in shaping early Internet regulation, because of concern about spillover effects when states regulate online conduct. In the prominent case of *American Library Association v. Pataki*, a district court struck down a New York law that prohibited the intentional use of the Internet to send pornographic messages that would be "harmful to minors."[9] The court conceded that shielding New York minors from pornography constituted a legitimate state interest.[10] But it found this interest was outweighed by the significant chilling effect the law would have on wholly out-of-state conduct.[11] Because information posted to the Internet is available everywhere simultaneously, those who disseminate information online could face liability for posting content that arguably ran afoul of New York's law, even if they had no intention of communicating with New York residents.[12] And this, in turn, would chill communication to recipients in states where the content was legal, thus imposing an undue burden on interstate commerce far in excess of what little local benefits were likely to result from enforcement.[13]

Like many balancing tests, the doctrine is somewhat unpredictable, turning on the facts of individual cases. Many state regulations create spillover effects; the Dormant Commerce Clause only invalidates those that, in the court's judgment, impose a greater burden on interstate commerce than they reap in local benefit – which can differ from case to case. For example, in *National Federation of the Blind v. Target Corp.*,[14] Target argued that California's disability law burdened interstate commerce by requiring it to modify a nationwide website to meet California requirements – which effectively imposed California law on the company's transactions with all customers, even those outside California.[15] The court found this argument was premature at the motion to dismiss stage, explaining that Target could develop a California-specific website, and even if it chose not to do so, its decision to develop one product for a nationwide market does not necessarily implicate the Commerce Clause.[16] At a minimum, factual development was necessary to determine the "practical effect" of the law on interstate commerce before the court could decide the Dormant Commerce Clause issue.[17]

National Federation of the Blind's focus on practical effects reflects the insights of Professors Jack Goldsmith and Alan Sykes, whose seminal Yale Law Journal article, *The Internet and the Dormant Commerce Clause*, brought some clarity to this somewhat confusing corner of the law.[18] Goldsmith and Sykes highlight that the primary justification for the Dormant Commerce Clause is to "ensure[] free trade among the states and thereby secure[] the associated economic benefits."[19] They thus support the consideration of economic efficiency as the lodestar for such claims: "[T[he appropriate statement of the extraterritoriality concern is that states may not impose burdens on out-of-state actors that outweigh the in-state benefits."[20]

III. The Dormant Commerce Clause and State Net Neutrality Efforts

Like early state attempts to regulate online conduct, state-level network traffic management regulations are susceptible to a Dormant Commerce Clause challenge. The Internet is a national (indeed, global) network, meaning that attempts to regulate the flow of traffic on that network are likely to have extraterritorial effects. If state net neutrality rules survive a preemption analysis, states should be ready for the claim that such regulations unreasonably burden interstate commerce and, therefore, contravene the Dormant Commerce Clause doctrine.

The party challenging the law bears the burden of showing the impact on interstate commerce.[21] As an initial matter, it is not clear that the existing state-level net neutrality initiatives are limited to in-state conduct. For example, Vermont's executive order prevents state agencies from contracting for broadband service unless the broadband provider certifies that it does not "engage in paid prioritization…to *any Internet customer*."[22] Similarly, Hawaii requires agencies to contract only with providers that "demonstrate and contractually agree to support and practice net neutrality principles where *all Internet traffic* is treated equally."[23] Facially, these restrictions can be read to apply not only to contracts with in-state consumers, but with all consumers nationwide (or indeed worldwide).[24]

But even if the court construes these restrictions to apply only to contracts with in-state consumers, such regulations can disrupt the orderly flow of interstate traffic. Permissible network management practices would differ from state to state, depending on whether and how each state chose to regulate. Even if all states adopted facially identical statutes, fragmentation is likely to occur over time as 50 different sovereigns may reasonably disagree on enforcement. For example, what constitutes "reasonable network management" may differ from state to state. Broadband providers are thus left with two alternatives: operate a nationwide network that meets the standards of the most stringent state – meaning that state's law burdens out-of-state communications that would otherwise be legal – or balkanize the network and make the delivery of network traffic less efficient, which burdens the delivery of out-of-state communications.

Similar burdens on out-of-state traffic undergirded the *Pataki* decision, and while *National Federation of the Blind* was less sympathetic to such claims, it did not discard them outright – a rather, the court withheld judgment until the magnitude of the burden could be quantified.

State-level traffic management rules also limit the services that carriers can offer on a national basis. As Thomas Hazlett has noted, the primary difficulty with state-level regulation of networks is the disruption of economies of scale that otherwise would occur at the national level.[25] Importantly, this has a negative effect not only on contracts with end-user consumers, but also with services and applications like prioritization or zero-rating that otherwise can be marketed to edge providers. As the Commission has observed, edge markets are primarily national in scope.[26] For congestion-sensitive applications such as streaming video or real-time video conferencing, prioritization can be a mechanism by which edge providers can deliver a better product to consumers without adversely affecting non-congestion-sensitive services. Similarly, the ability to zero-rate a particular offering can help expand the planes of competition among edge providers and allow smaller providers a chance to gain an advantage over rivals. If broadband providers cannot market such services nationally, they are less likely to achieve national economies of scale and services will be provided less efficiently. At the extreme, the inability to offer prioritization or zero-rating nationally may deter edge providers from purchasing and making available such services at all – meaning these consumer-friendly offerings will be unavailable even in states where consumers want them and regulators have not banned them.

Once plaintiffs have established that a law burdens interstate commerce, the burden shifts to the state to establish the local benefit.[27] Many states have been careful to rehearse the claimed benefits of net neutrality rules. The Vermont statute, for example, explains that because the Green Mountain State is "a rural state with many geographically remote locations…many Vermonters do not have the ability to choose easily between Internet Service Providers (ISPs). This lack of a thriving competitive market, particularly in isolated areas, disadvantages the ability of consumers and businesses to protect their interests sufficiently," thus warranting government regulation.[28] Similarly, California's legislature found that "[a]lmost every sector of California's economy, democracy, and society is dependent on the open and neutral Internet that supports vital functions" such as police and emergency services, health services, utilities, and education.[29]

But these states may struggle to quantify these claimed benefits in any convincing way. As one court noted, "to determine what the ‘practical effects' of the regulation are, courts should inquire into the actual effects of the legislation rather than the effects intended by the legislature."[30] Indeed, the *Pataki* court invalidated New York's anti-pornography statute in part because it found that that statute likely would have little incremental benefit in practice beyond that already conferred by other, overlapping laws.[31] Similarly, net neutrality skeptics have often cited the dearth of evidence that net neutrality rules are necessary to protect consumers from real harm – the history of broadband development before the 2015 *Open Internet Order* and since its 2018 repeal suggest otherwise. And while net neutrality proponents claim that regulation can promote other values – such as the 2015 *Open Internet Order*'s claim of a "virtuous cycle" that net neutrality will promote edge investment, which in turn will stimulate demand for greater network investment – the evidence supporting these clams is equally thin, as Judge Williams noted in his dissent in *US Telecom Association*.[32] (The majority gave the FCC the benefit of the doubt because of the "highly deferential" standard of review governing agency predictive judgments in administrative settings, and courts may extend similar deference to state legislatures' conclusion as well.)[33]

IV. Conclusion

Of course, there is also a political dimension to states' willingness to take net neutrality actions. To the extent that the residents of states such as Vermont and California feel more strongly in favor of net neutrality protections than consumers in other parts of the country, the states' willingness to enact a rule, risk a federal preemption challenge, and expend public time and resources on enforcement keeps the political issue alive and signals the strength of their interest to national lawmakers, influencing the national debate. In this sense, it is perhaps unsurprising that the primary catalysts of state net neutrality rules are not state public utility commissioners but governors and state legislators. They are directly elected by their constituents and, therefore, are well placed to read their constituents' preferences and communicate them nationally.

But the Dormant Commerce Clause doctrine checks this political activism, to make sure that these states' efforts to register their discontent with federal policy do not unduly burden residents of other states whose preferences differ. It is difficult to predict in advance how courts may resolve Dormant Commerce Clause claims in this context, given the need to develop a robust record of the burdens and benefits of particular state laws and executive actions. But at a minimum, one can say that the various state initiatives are susceptible to a Dormant Commerce Clause challenge.

The FCC is correct that broadband is an inherently interstate service and that traffic management practices are best determined by a national regulator to control the spillover effects that would otherwise occur with state-level action. For states that insist upon taking that power into their own hands, preemption of state net neutrality laws or executive orders will be the first obstacle, and this is where the battle has been joined thus far. But even if the state actions survive a preemption challenge, the Dormant Commerce Clause doctrine will be yet another gauntlet that must be overcome in their quest to undermine the *Restoring Internet Freedom Order*.

* Daniel A. Lyons, a Professor of Law at Boston College Law School, is a Member of the Free State Foundation's Board of Academic Advisors. The Free State Foundation is an independent**,** nonpartisan free market-oriented think tank located in Rockville, Maryland.

---

[1] See Restoring Internet Freedom, 33 FCC Rcd. 311, 427-429 (2018).

[2] See Haw. Exec. Order No. 18–02 (2018); Mont. Exec. Order No. 3-2018 (2018); N.J. Exec. Order No. 9 (2018); N.Y. Exec. Order No. 175 (2018); R.I. Exec. Order No. 18–02 (2018); Vt. Exec. Order No. 2–18 (2018).

[3] S.B. 822. 2018 Gen. Assemb. (Cal. 2018); H.B. 4155, 79th Leg. Assemb., Reg. Sess. (Or. 2018); S. 289 (Vt. 2018); H.B. 2282, 65th Leg., Reg. Sess. (Wash. 2018).

[4] See Daniel A. Lyons, *Express and Conflict Preemption of State Net Neutrality Efforts*, PERSPECTIVES FROM FSF SCHOLARS VOL. 14, No. 4 (2019).

[5] U.S. Const. Art. I, § 8, cl. 3.
[6] C&A Carbone v. Town of Clarkstown, NY, 511 U.S. 383, 390 (1994).
[7] South Dakota v. Wayfair, Inc., 138 S.Ct. 2080, 2091 (2018) (quoting Granholm v. Heald, 544 U.S. 460, 476, 125 S.Ct. 1885, 161 L.Ed.2d 796 (2005)).
[8] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).
[9] American Library Ass'n v. Pataki, 969 F. Supp. 160 (S.D.N.Y. 1997).
[10] *Id*. at 177.
[11] *Id*.
[12] *Id*.
[13] *Id*. at 179-180.
[14] 452 F. Supp. 2d 946 (N.D. Cal. 2006).
[15] *Id*. at 961.
[16] *Id*.
[17] *Id*. at 962.
[18] Jack L. Goldsmith and Alan O. Sykes, *The Internet and the Dormant Commerce Clause*, 110 YALE L.J. 785 (2001).
[19] *Id*. at 795.
[20] *Id*. at 804.
[21] See Hughes v. Oklahoma, 441 U.S. 322, 336 (1979).
[22] Vt. Exec. Order No. 2–18 (2018).
[23] Haw. Exec. Order No. 18–02 (2018).
[24] It is worth noting that the executive orders, and two of the four statutes, do not regulate broadband providers directly, but instead require them to commit to net neutral practices as a condition of receiving government contracts. This is an attempt to fit these regulations into the market participant doctrine, which is an exception to the Dormant Commerce Clause doctrine. But because most of these initiatives reach beyond the terms of the state's own contracts, and instead attempt to regulate contracts between broadband providers and third-party consumers, they fall outside the market participant doctrine, as Seth Cooper and I have each discussed at greater length elsewhere. See Seth L. Cooper, *State Executive Orders Reimposing Net Neutrality Regulations Are Preempted by the* Restoring Internet Freedom Order, PERSPECTIVES FROM FSF SCHOLARS VOL. 13, No. 5 (2018); Daniel A. Lyons, *Express and Conflict Preemption of State Net Neutrality Efforts*, PERSPECTIVES FROM FSF SCHOLARS VOL. 14, No. 4 (2019).
[25] Thomas W. Hazlett, *Is Federal Preemption Efficient in Cellular Phone Regulation?*, 56 FED. COMM. L.J. 155,175 (2003).
[26] See Restoring Internet Freedom, 33 FCC Rcd. 311, 430-431 (2018).
[27] USA Recycling, Inc. v. Town of Babylon, 66 F.3d 1272, 1281 (2d Cir. 1995).
[28] See S. 289 (Vt. 2018).
[29] See S.B. 822, 2018 Gen. Assemb. (Cal. 2018).
[30] *National Federation of the Blind*, 452 F. Supp. 2d at 960; see also Healy v. Beer Institute, 491 U.S. 324, 336 (1989) ("The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State."). While the court in that instance was discussing the need to quantify the burden on interstate commerce, a proper cost-benefit analysis requires a similar quantification of the offsetting benefit, as the *Pataki* court discusses in depth.
[31] *Pataki*, 969 F. Supp. at 179.
[32] See US Telecom Ass'n v. FCC, 825 F.3d 674, 754 (2016) (Williams, J., dissenting).
[33] Cf. Turner Broadcasting Sys., Inc. v. FCC, 520 U.S. 180, 195 (1997) ("In reviewing the constitutionality of a statute, courts must accord substantial deference to the predictive judgments of Congress. Our sole obligation is to assure that, in formulating its judgments, Congress has drawn reasonable inferences based on substantial evidence.").