

NEW JERSEY'S ETHANOL EXEMPTION ACT: INDUSTRY'S CATALYST OR PROTECTIONIST?

Introduction

In the 1970's, an American alcohol fuel industry emerged in reaction to the energy crisis.¹ Gasoline shortages and inflated petroleum prices brought America to the realization that national security was threatened by dependence upon foreign oil.² Although the lines at the gas stations have now vanished, the probability of future disruption in the nation's oil supply is real. The Iran-Iraq war, the political unrest in the oil-producing nations, along with other recent global developments, accentuate this threat.³ As a result, the nation has turned toward the development of domestic fuel sources.⁴ One alternative that has

¹ See ETHANOL: PERFORMING FOR AMERICA, AN INDUSTRY REPORT BY THE RENEWABLE FUELS ASSOCIATION (1983) (available at Renewable Fuels Association, 499 S. Capital Street, Suite 420, Washington, D.C. 20003) [hereinafter cited as INDUSTRY REPORT]. Essentially, the INDUSTRY REPORT supports the proposition that ethanol is an important domestic energy source for the United States. The Report notes, "As a friend to farmers, as a provider of jobs and economic growth, as a contributor to a cleaner environment, as a bolsterer to national security, the fuel ethanol industry is performing for America." *Id.* at 1. See also Daschle, *Congressional Action on Ethanol: Fulfilling the Need for a Renewable Domestic Motor Fuel*, 25 S.D.L. REV. 297 (1980). Congressman Daschle, in this article, espouses the need for government incentives to stimulate the continued production and development of fuel ethanol in the United States. In addition, the article outlines different pieces of legislation aimed at this objective, and some of the pitfalls that have been encountered.

² INDUSTRY REPORT, *supra* note 1, at 2.

³ See Comment, *Nebraska's Legislative Responses to the Energy Crisis: Solar Energy, Gasohol, and the Conservation Ethic*, 60 NEB. L. REV. 327 (1981). Since a majority of the nation's crude oil and petroleum products come from outside the United States the nation must take steps to protect itself. Indeed, between 1970 and 1973 American consumption of crude oil and refined petroleum products increased from 14.7 to 18.73 million barrels per day (mbd). Daschle, *supra* note 1, at 299. More importantly, imports of these products rose from 3.42 mbd in 1970 to 8.19 mbd in 1978, with OPEC members exporting 1.67 mbd in 1971, 6.19 mbd in 1977 and 5.61 mbd in 1978. *Id.* The extent of these imports has remained somewhat constant with the United States expending \$62 billion on foreign oil in 1982. INDUSTRY REPORT, *supra* note 1, at 7. These figures clearly represent the nation's continued dependence on foreign oil. Should anti-West sentiments be aroused in this part of the world, America could once again find itself facing an energy crisis.

⁴ INDUSTRY REPORT, *supra* note 1, at 2. Along with ethanol, development in the oil shale industry has been explored. Because of the centralized nature of the in-

gained considerable legislative support is the use of ethanol, more commonly known as "grain alcohol" or "ethyl alcohol," as a liquid motor fuel.⁵

The New Jersey Legislature has contributed its support to the fuel ethanol industry by enacting legislation aimed at encouraging the production and consumption of ethanol.⁶ The Act provides for a temporary and limited exemption for certain alcohol-blend motor fuels from the general excise tax on motor fuels.⁷ This tax benefit, however, applies only to grain derived ethyl alcohol produced in the Garden State from whole grain.⁸ Thus, only ethanol produced in New Jersey is entitled to the exemption. Bolstered by strong bipartisan support, the Act was quickly adopted by the Legislature.⁹

This note examines both the use of ethanol and New Jersey's legislation promoting the ethanol industry. The prefermental efforts of the federal government and other states will also be discussed. More importantly, the constitutional ramifications of the Garden State's statute in light of the Commerce Clause will be analyzed. An examination of recent case law involving analogous statutes suggests that the New Jersey law may not pass constitutional muster. In order to fully recognize the import of this legislation, however, an examination of the ethanol industry and its product must initially be undertaken.

Ethanol Use and Make-up

The use of alcohol in the beverage and pharmaceutical in-

dustry and the necessary billion dollar investment, however, the oil shale industry has faltered despite government assistance. *Id.*

⁵ Daschle, *supra* note 1, at 297. See *infra* text accompanying note 39.

⁶ N.J. STAT. ANN. § 54:39-2, 27 (West Supp. 1985-86).

⁷ *Id.* § 54:39-27(a). The exemption is intended to provide an incentive to potential producers and consumers of alcohol-blend motor fuel by temporarily lowering the motor fuels tax on this type of fuel. ASSEMBLY STATEMENT TO A-1713, 201st LEGISLATURE, 1st SESS. (1984).

⁸ N.J. STAT. ANN. § 54:39-2(d) (West Supp. 1985-86). Whole grain distillation must be distinguished from synthetic ethanol production. The use of whole grain provides the necessary components to effectively produce ethyl alcohol and its by-product, distiller's dried grain. See *infra* notes 28-33 and accompanying text.

⁹ Introduced on May 21, 1984, A-1713 was unanimously approved in both houses (Assembly vote 64-0; Senate vote 39-0). On July 18, 1984, the bill was signed into law and took effect immediately upon passage.

dustries has long been established.¹⁰ As a motor fuel, alcohol's use has sparked interest in this country for over a century.¹¹ This industry, however, has never attracted greater attention than that which exists today.¹² Increased ethanol legislation¹³ and production facilities¹⁴ manifest this burgeoning interest. But what is ethanol and how can it be used?

Ethanol can be burned in internal combustion engines in its pure form (neat ethanol) or blended with gasoline.¹⁵ Engines

¹⁰ See STANDARD ENCYCLOPEDIA OF THE ALCOHOL PROBLEM, vol. 1, 126 (1925). The encyclopedia authors note that "[i]t is generally admitted that as early as the time of the classic teachers of medicine, alcoholic liquors had come into use for the treatment of sickness." *Id.* From Hippocrates (b.460 B.C.) to Galen (A.D. 131-C.200) and throughout the Nineteenth century, alcohol was vigorously applied in the treatment of all inflammatory diseases. *Id.* Indeed,

Physicians ascribed to alcohol after its discovery the greatest medicinal power, treating it as a marvelous panacea for all disorders; thus they established it in the eyes of the people as infallible and indispensable! Although ardent spirits were unable to fulfill this role, and although they sank from a highly prized drug to a common household medicine and then to much abused beverages and as a means of intoxication, yet they continued to hold their place in the medicine-chest of the physician as a much used remedy.

Id. More recently, alcohol's use as a remedy has declined due to the habit-forming tendencies of alcohol. Alcohol's use as a beverage, however, continues to pervade society.

¹¹ See Daschle, *supra* note 1, 298-299 for a historical analysis of alcohol-blend motor fuel in America. Henry Ford, the automobile pioneer, promoted alcohol as a motor fuel in a number of ways. Ford used alcohol to fuel a pre-war of the century automobile known as the quadricycle; equipped an early Model A with an alcohol adjustable carburetor; and sponsored conferences in the 1930's that discussed the use of alcohol as a motor fuel. Bernton, *The Godfather of Gasohol Is . . . Henry Ford!* Washington Post, Aug. 5, 1979, § B, at 1, col. 1.

¹² In 1983, over 40 billion gallons of ethanol were sold occupying 4 percent of total gasoline sales in the United States. INDUSTRY REPORT, *supra* note 1, at 1. More recently it has been estimated that ethanol blend sales reached 5.31 percent of the total gasoline market. *Alcohol Outlook, Alcohol Market Analysis and Industry Trends*, Information Resources, Inc. (August 1984) (available at Information Resources, Inc., 499 South Capital Street, Suite 420, Washington, D.C. 20003) [hereinafter cited as *Alcohol Outlook*].

¹³ In addition to federal legislation, nearly forty states have enacted some form of ethanol legislation. See *infra* notes 40-58 and accompanying text.

¹⁴ In 1983, there were an estimated eighty ethanol production facilities in the United States. INDUSTRY REPORT, *supra* note 1, at 5.

¹⁵ BIOMASS ENERGY PRODUCTION AND USE PLAN FOR THE UNITED STATES, 1983-1990, Agricultural Economic Report No. 505 (1983), a combined report by the U.S. Dept. of Agriculture, U.S. Dept. of Energy, Office of Energy, Office of Alcohol Fuels and Office of Renewable Technology (available at U.S. Gov't. Printing Office, Washington, D.C. 20402) [hereinafter cited as BIOMASS PLAN].

designed to burn gasoline require major modifications in order to burn neat ethanol.¹⁶ These modifications, however, are not required when gasoline and alcohol are blended.¹⁷ Generally, products marketed as "gasohol" or, more recently, "unleaded with ethanol," are blends of ten percent ethyl alcohol and ninety percent gasoline.¹⁸ The use of these blends has become particularly significant,¹⁹ because of the inclusion of the use of ethanol by the nation's major automobile manufacturers in their product's warranties.²⁰

Two major contributing factors in the growth of fuel ethanol consumption are ethanol's twin attributes—fuel extension and octane enhancement.²¹ As a fuel extender, ethanol burns more completely than gasoline and thus realizes more of its energy potential.²² In terms of octane enhancement, ethanol blended with gasoline increases octane ratings an average of three points.²³ An additional consideration is the ecologically-sound nature of ethanol. As a potential substitute for lead in gasoline,²⁴ and through reduced hydrocarbon and carbon monoxide emissions,²⁵ ethanol contributes to a cleaner and safer environment.²⁶ Furthermore, the production of fuel ethanol does not pose the threats to the environment which are present in other alternative

¹⁶ *Id.* at 6.

¹⁷ *Id.* Blends of gasoline containing up to twenty percent ethanol do not require engine modification. *Id.*

¹⁸ *Id.*

¹⁹ See *Alcohol Outlook*, *supra* note 12, at 2. Currently it has been estimated that ethanol blend sales reached 435 million gallons and constituted 5.31 percent of the total gasoline marketed in the United States. *Id.*

²⁰ INDUSTRY REPORT, *supra* note 1, at 2. The top twenty United States Auto Marketers approve the use of ethanol fuel. *Id.*

²¹ BIOMASS PLAN, *supra* note 15, at 6. Each gallon of ethanol contains about 85,000 Btu (British thermal unit) of energy as compared to 125,000 Btu per gallon of gasoline. Ethanol, however, burns more completely than gasoline and thus realizes more of its energy potential. *Id.* As an octane enhancer, ethanol's octane rating (110-112) is greater than that of gasoline (87 for regular unleaded). *Id.* As a result, ethanol may prove to be an important substitute for lead, which is being phased out under Environmental Protection Agency regulations. *Id.*

²² BIOMASS PLAN, *supra* note 15, at 6.

²³ *Id.*

²⁴ *Id.* See also INDUSTRY REPORT, *supra* note 1, at 8.

²⁵ INDUSTRY REPORT, *supra* note 1, at 8. When compared to unleaded gasoline, blends of ethanol and unleaded gasoline reduced hydrocarbon emissions by ten percent and lowered carbon monoxide emissions by twenty-five percent. *Id.*

²⁶ INDUSTRY REPORT, *supra* note 1, at 6.

energy sources.²⁷ While the surface mining of coal rapes the landscape and nuclear waste threatens our biological make-up, ethanol is a natural, renewable energy source.

Ethanol can be created by fermenting almost any material containing carbohydrates.²⁸ Corn has been the preferred feedstock in most commercial operations,²⁹ but other fermentable materials can be utilized.³⁰ In producing ethanol from corn two techniques have been developed,³¹ each yielding a high protein feed supplement as a byproduct.³² The recovery and use of these byproducts is not only resource effective, but also is essential to economical alcohol fuel production.³³

²⁷ *Id.* Unlike oil shale and coal surface mining which require destruction of the earth's surface, ethanol is an energy source produced from grains and other fermentable material.

²⁸ Daschle, *supra* note 1, at 297, n.1.

²⁹ BIOMASS PLAN, *supra* note 15, at 6. The use of grain, more specifically corn, is an important feature of the ethanol industry. In 1982, a corn surplus led to lower corn prices, depressed farm income, and increased government support. As a result of this surplus, the government paid farmers to keep land idle. INDUSTRY REPORT, *supra* note 1, at 3. The ethanol industry can help to reduce that surplus and provide an additional market for farmers to dispose of their corn. *Id.*

New Jersey's law also espouses a preference for grain derived ethanol. Since corn is of plentiful supply in New Jersey, the motivation for this bias is obvious. With available raw materials and favorable legislation, the ethanol industry should have little trouble establishing itself in New Jersey. *See infra* notes 80-87 and accompanying text.

³⁰ Daschle, *supra* note 1, at 297-8, n.1. Some waste products, such as fruit residues, cheese whey and cull potatoes, may produce ethanol at a low cost, but only limited quantities of these feedstocks are available. BIOMASS PLAN, *supra* note 15, at 6. The use of other materials, like wood and crop residue, for producing ethanol is also technologically feasible, but because of a low alcohol conversion rate they have not proved economically competitive on a commercial basis. *Id.*

³¹ BIOMASS PLAN, *supra* note 15, at 8. Wet-milling and dry-milling are the two methods used in producing grain derived ethanol. *Id.* The two real distinctions between these two processes is the use of water and resulting byproducts. The byproduct of wet-milling is corn gluten feed and in dry-milling distiller's dried grain. Both byproducts are high in protein, and have established markets as a cattle feedstock. *Id.*; *see* INDUSTRY REPORT, *supra* note 1, at 4.

³² BIOMASS PLAN, *supra* note 15, at 8. In both processes, only the starch is used to produce the fuel ethanol. Thus, all of the original protein, vitamins, and minerals of the grain are retained as the byproduct of ethanol production. INDUSTRY REPORT, *supra* note 1, at 4. Corn gluten feed, the byproduct of wet-milling production, is exported to Europe. Distiller's dried grain, on the other hand, is sold in the domestic market as a cattle feed supplement for livestock. BIOMASS PLAN, *supra* note 15, at 8.

³³ Daschle, *supra* note 1, at 298 n.1. Two issues that have dominated the debate over alcohol fuel production are the "food versus fuel" issue and the "net energy

Ethanol production costs vary depending on the method of technology employed and the size of the facility.³⁴ Additional outlays, for such essentials as feedstock, energy and labor are also important expenditures.³⁵ The availability of byproduct credits, as well as established foreign and domestic markets for these byproducts, assist in defraying expenses.³⁶ More importantly, these ethanol production costs can be reduced through federal and state tax incentives,³⁷ such as those passed in New Jersey. Thus, by virtue of energy efficiency, environmental preservation and legislative incentives, ethanol has become an increasingly important energy source.³⁸

Federal and State Incentives

The significance of alcohol-blend motor fuels becomes apparent upon examination of the federal government's energy

balance" issue. Critics of alcohol fuel production argue that increased production of alcohol for fuel could lead to food shortages. There is little evidence to support that contention, however. *Id.* First, a whole host of materials contain the necessary carbohydrates to produce ethanol. *See supra* note 30. More importantly, as the INDUSTRY REPORT points out, "[t]here is no 'food versus fuel' tradeoff because the nutritional components of greatest need throughout the world—protein and calories—are separated and redirected into the food chain." INDUSTRY REPORT, *supra* note 1, at 3.

Critics also contend that ethanol is an inefficient energy source because it represents a "negative energy balance." "Negative energy balance" refers to the theory that more energy is consumed in the production of ethanol than is derived from the resulting fuel. *See* Daschle, *supra* note 1, at 298 n.1. This theory is based on an analysis of the alcohol beverage industry's use of energy in its production process. *Id.* The analysis is misleading for two reasons. First, alcohol for human drink requires more energy to become chemically pure and tasteless, whereas alcohol for motor fuel need not be so pure. *Id.* Moreover, the alcohol beverage industry's production process was developed in an era when energy was abundant and cheap. Hence, existing alcohol production facilities are not energy efficient. *Id.* Today, in contrast, energy conservation and efficiency are important. As a result, present and new techniques are likely to further decrease the amount of energy consumed in alcohol fuel production. *Id.*

³⁴ BIOMASS PLAN, *supra* note 15, at 8. "Currently, about one-half of fuel ethanol production is by one company that uses the wet-milling process. Its cost data are proprietary." *Id.* Using the dry-milling technology, costs were estimated to average \$1.57 per gallon in 1982 for facilities with a forty million gallon production capacity. *Id.* at 11.

³⁵ BIOMASS PLAN, *supra* note 15, at 11.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *See generally*, INDUSTRY REPORT, *supra* note 1.

policy. The ethanol industry's development in this country can be attributed in part to tax incentives provided at both the federal and state levels. These inducements have exhorted private industry to enter, develop and promote the alcohol fuel industry in the United States.³⁹ Federal encouragements are reflected in the Energy Tax Act of 1978 (Energy Tax Act)⁴⁰ and the Crude Oil Windfall Profit Tax Act of 1980 (WPT Act).⁴¹ In order to further the production of ethanol, these laws have provided energy investment credits,⁴² income tax credits,⁴³ and most important to this discussion, excise tax exemptions.⁴⁴

Under the federal tax code, energy investment credits are available to businesses if energy property is acquired during a given year.⁴⁵ This energy credit is ten percent of the investment in energy property.⁴⁶ An additional income tax credit is available for the use of alcohol as a fuel, either alone or in a mixture with gasoline or other fuels.⁴⁷ The credit is forty cents for each gallon of alcohol used in a mixture or by itself after October 1980 and

³⁹ Daschle, *supra* note 1, at 298.

⁴⁰ Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174 (1978) (codified as amended in scattered sections of the I.R.C.). This Act represents a major development in the energy policy of the United States. Through energy investment credits of ten percent in energy property, the government sought to pursue an energy policy via tax incentives. See Mendelson, *Tax Incentives for Ethanol Production: A Practitioner's Guide*, 43 U. PITT. L. REV. 125 (1981).

⁴¹ Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229 (codified in scattered sections of I.R.C.). To augment the incentives provided in the Energy Tax Act, the WPT Act extended these incentives. Ostensibly this extension is due to the success of the incentives in attracting potential investors. See Mendelson, *supra* note 40, at 125.

⁴² I.R.C. § 48(l) (1978). This energy investment credit equals ten percent of the total investment in energy property defined in § 48(l), (2).

⁴³ I.R.C. § 44E (1980). This section permitted a credit of forty cents for each gallon of alcohol used alone or in mixture.

⁴⁴ I.R.C. § 4041(k)(l) (1980). New Jersey's Ethanol Exemption Act proposes an eight cent excise tax exemption. N.J. STAT. ANN. § 54:39-27(b)(l) (West Supp. 1985-86).

⁴⁵ I.R.C. § 48(l). See also Mendelson, *supra* note 40, at 129. In relevant part, this section provides a ten percent income tax credit for investment in energy property acquired or constructed after September 1978. *Id.* "Energy property" for ethanol production includes alternative energy property, specially defined energy property, and biomass property, which are depreciable, have a useful life of at least five years, and are not public utility property. I.R.C. § 48(l), (2).

⁴⁶ I.R.C. § 48(l).

⁴⁷ I.R.C. § 44E. See Mendelson, *supra* note 40, at 137.

through December 1992.⁴⁸ Moreover, the Acts exempt "gasohol" from the federal four cent per gallon excise tax on motor fuels.⁴⁹ The federal government has also encouraged the alcohol-fuel industry with the enactment of the Biomass Energy and Alcohol Fuels Act.⁵⁰ Providing loans,⁵¹ loan guarantees,⁵² and price guarantees,⁵³ the "Alcohol Fuels Act" established the Office of Alcohol Fuels to oversee the distribution of these benefits.⁵⁴ Through such initiatives, Congress has provided the catalyst for the furtherance of the alcohol-fuel industry.

Many states have also implemented an energy program aimed at stimulating the alcohol-fuel industry.⁵⁵ In addition to federal government incentives, numerous states exempt alcohol-fuels from all or part of their gasoline excise taxes.⁵⁶ The variety

⁴⁸ I.R.C. § 44E.

⁴⁹ I.R.C. § 4041(k)(l).

⁵⁰ Biomass Energy and Alcohol Fuels Act of 1980, 42 U.S.C. § 8801 (1980).

⁵¹ 42 U.S.C. § 8813. This section provides insured loans for small scale biomass energy projects subject to application and approval by the Secretary of Agriculture. *Id.*

⁵² 42 U.S.C. § 8814(a). The Secretary may guarantee, pursuant to this section, against the loss of principal and interest, loans which are made to provide funds for the construction of biomass energy projects. *Id.*

⁵³ 42 U.S.C. § 8815(a). Subject to application, the Secretary may guarantee that the price to be received for the production will not be below a specified price. *Id.*

⁵⁴ 42 U.S.C. § 8820.

⁵⁵ Most states have some type of tax incentive for alcohol-blend motor fuel. Nearly thirty-five states provide some form of tax exemption. *See e.g.* ALA. CODE § 40-17-130 (Supp. 1984); ALASKA STAT. § 43.40.100 (1980); ARK. STAT. ANN. § 75-1242 (Supp. 1983); CAL. [REV. & TAX] CODE § 6357.5 (West Supp. 1985); CONN. GEN. STAT. ANN. 12-458 (West Supp. 1985); FLA. STAT. ANN. § 212-63 (West 1984); HAWAII REV. STAT. § 237.21.1 (1981); IDAHO CODE § 63-2405 (1983); ILL. REV. STAT. ch. 120, § 441 (West Supp. 1985); IND. CODE ANN. § 6-2.5, 2.8 (West 1980); IOWA CODE ANN. § 422.45 (West Supp. 1985); KAN. STAT. ANN. § 79-3408 (1984); KY. REV. STAT. § 138.20.223 (1982); LA. REV. STAT. ANN. § 47:802.1 (1979); ME. REV. STAT. ANN. tit. 36, § 2903 (West Supp. 1984-85); MD. CODE ANN. art. 56, § 136 (Supp. 1984); MICH. COMP. LAWS ANN. § 207.102 (West Supp. 1985); MINN. STAT. ANN. § 296.02 (West Supp. 1985); MISS. CODE ANN. § 27-65-11 (Supp. 1984); MONT. CODE ANN. §§ 15-70-522, 523 (1983); N.M. STAT. ANN. § 7-13.4.2 (1981); N.C. GEN. STAT. § 105-436.1(b) (1979); N.D. CENT. CODE § 57-43.1.02 (1983); OHIO REV. CODE ANN. § 57-35.14.5 (Page Supp. 1984); S.D. CODIFIED LAWS ANN. § 10-17-2.1 (1983); TENN. CODE ANN. § 67-3-618 (1982); TEX. STAT. ANN. art. 153.123 (Vernon 1984); UTAH CODE ANN. § 41-11-6 (Supp. 1983); VA. CODE § 58:1-2105 (Supp. 1985); WASH. REV. CODE ANN. § 82.36.225 (West Supp. 1985).

⁵⁶ *See supra* note 55 for list of states with some form of tax exemptions.

of tax exemptions are numerous,⁵⁷ and several states, including New Jersey, have placed limitations on the entities who benefit from these exemptions.⁵⁸

The nationwide use of ethanol tax exemptions to stimulate ethanol production is not a new idea. Like any nascent industry, inadequate financial support or the lack of incentives for development and production could easily thwart the ethanol industry's growth.⁵⁹ The federal government and many states have recognized this financial problem, and have attempted to alleviate it through the use of tax exemptions. For New Jersey, the exemption is an important first step for the ethanol industry. In accordance with the national policies of energy conservation, domestic fuel production and environmental preservation, the exemption helps to defray the expensive costs of developing this industry.

New Jersey's Ethanol Exemption Act

Following the trend toward energy conservation, domestic fuel production, and environmental preservation, the New Jersey Legislature approved the Ethanol Exemption Act in the summer of 1984.⁶⁰ The Ethanol Exemption Act⁶¹ provides a temporary and limited exemption for certain alcohol-blend fuel from the tax on motor fuel.⁶² The tax exemption begins October 1, 1985 and continues until January 1, 1992.⁶³ The espoused purpose of the

⁵⁷ See BIOMASS PLAN, *supra* note 15, at 9. State laws provide a schedule of exemptions which vary over time and restrictions. In 1983, the exemptions averaged 4.3 cents per gallon of ethanol in states that provided exemptions and averaged 2.3 cents per gallon on a national scale. *Id.*

⁵⁸ For example, some states have reciprocity clauses while others limit the exemption to a minimum eligible blend. See ARK. STAT. ANN. § 75-1242 (1981) (limited exemption with reciprocity); WASH. REV. CODE ANN. § 82.36.225 (1981) (limited to minimum eligible blend of 9.5%). Some states, like New Jersey, limit the exemption to grain derived ethyl alcohol produced in their own state. See e.g. MONT. CODE ANN. §§ 15-70-522, 523 (1983); LA. REV. STAT. ANN. § 47:802.1 (1979); N.M. STAT. ANN. § 7-13-4.2 (1981); N.J. STAT. ANN. § 54:39-2, 27 (West Supp. 1985-86).

⁵⁹ Daschle, *supra* note 1, at 308.

⁶⁰ N.J. STAT. ANN. §§ 54:39-2, 27 (West Supp. 1985-86).

⁶¹ *Id.*

⁶² *Id.* § 54:39-27(b).

⁶³ *Id.* Pursuant to this schedule of taxation, alcohol-blend motor fuel is exempt from the entire tax from October 1985, through December, 1987. Thereafter, the applicable rates are: two cents per gallon are exempt from January 1988, through December 1989; four cents per gallon are exempt from January 1990, through De-

Act is to provide an incentive to potential producers and consumers of alcohol-blend motor fuel by temporarily lowering the state's tax on this type of fuel.⁶⁴

Pursuant to the Act, every gasoline distributor and wholesaler must render a monthly report to the Department of Taxation declaring the number of gallons of fuel sold.⁶⁵ Accompanying the report should be a tax payment of eight cents per gallon,⁶⁶ except for alcohol-blend fuel which is exempt from the tax.⁶⁷ The tax on alcohol-blend fuel is paid according to a different schedule of taxation.⁶⁸ As a result, if the existing gasoline tax is altered, the tax on alcohol-blend fuel would reflect this change.⁶⁹

Alcohol-blend motor fuel, as defined in the Act is:

a liquid or gaseous substance, sold or used to propel motor vehicles upon the public highways, which is gasoline combined with a minimum 10 percent grain derived ethyl alcohol, whose purity shall be at least 99 percent alcohol, produced in the State from whole grain.⁷⁰

Thus, for a period of approximately six years, alcohol-blend motor fuel produced in New Jersey is entitled to a limited tax exemption from the existing gasoline excise tax.⁷¹

By temporarily lowering the motor fuels tax on alcohol-blend fuel, the legislature hopes to stimulate potential producers and consumers into using this type of fuel.⁷² The legislature's purpose is

ember 1991; and after December 31, 1991, the tax will be levied at the full eight cents per gallon. *Id.*

⁶⁴ ASSEMBLY STATEMENT TO A-1713, 201st LEGISLATURE, 1st SESS. (1984).

⁶⁵ N.J. STAT. ANN. § 54:39-27.a. (West Supp. 1985-86).

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.* § 54:39-27.b. See *supra* note 63 for the taxation schedule.

⁶⁹ *Id.*

⁷⁰ *Id.* § 54:39-2(d). In addition to the in-state distillation requirement, the exemption is also limited to whole grain derived ethyl alcohol. *Id.* It should be noted that ethanol can also be produced synthetically. The importance of whole grain derivation is based on the economy of the production method. Furthermore, the whole grain requirement assists the agricultural market in the disposition of surplus grain. INDUSTRY REPORT, *supra* note 1, at 3.

⁷¹ N.J. STAT. ANN. § 54:39-2, 27 (West Supp. 1985-86). Prior to this amendment, the motor fuels tax was eight cents per gallon of all fuel sold. The amendment, therefore, only provided an exemption for alcohol-blend fuel from this eight cent tax.

⁷² ASSEMBLY STATEMENT TO A-1713, 201st LEGISLATURE, 1st SESS. (1984).

certainly noble, since the use of ethanol in America may prove to be an important source of domestic energy.⁷³ New Jersey's Act can only help to further develop and enhance the use of this energy source. The tax benefit provided by New Jersey only applies to grain-derived ethyl alcohol produced in New Jersey.⁷⁴ Thus, only in-state ethyl alcohol producers are granted the exemption. The Act, therefore, has an additional purpose—to allow New Jersey to compete with other states in the emerging ethanol industry.⁷⁵ Indeed, the Office of the Governor,⁷⁶ the Department of Agriculture,⁷⁷ and the Department of Treasury-Division of Taxation⁷⁸ all have concurred that the exemption is in New Jersey's long term economic interests. New Jersey's exemption, however, may constitute "economic protectionism."⁷⁹ While the general purpose of the Act is laudable, the economic balkanization that results may have deleterious constitutional ramifications.⁸⁰

The Legislature has accomplished the objective of sparking investment in New Jersey's ethanol industry. Currently, the construc-

⁷³ See *supra* notes 21-27 and accompanying text.

⁷⁴ ASSEMBLY STATEMENT TO A-1713, 201st LEGISLATURE, 1st SESS. (1984).

⁷⁵ Letter from W. Carey Edwards, Chief Counsel to the Governor of New Jersey, to Alan Karcher, Speaker of the New Jersey General Assembly (June 13, 1984) (discussing A-1713, and pledging the Governor's support).

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ Letter from John R. Baldwin, Director of the Division of Taxation, to W. Carey Edwards, Chief Counsel to the Governor of New Jersey (May 1, 1984) (declaration of support for the ethanol exemption bill). In addition, the Division of Taxation conducted an economic analysis which concluded that the State would receive a net gain in the year the exemption was in effect. The study also concluded that the State would receive a one-time tax revenue for the plant's construction and that local municipalities would benefit through an increase in additional local property taxes. See Letter from John T. Bodnar, Assistant to the Director of Taxation, to Jane Kelly, Assistant Counsel to the Governor of New Jersey (May 4, 1984) (memo on ethanol tax incentive). As a result of the favorable economic analysis, it was noted that "[i]t is our understanding that this legislation is needed to induce the establishment of an ethyl alcohol industry in the State. The tax benefits attributable to the economic activity generated by this industry and spin-off industries would appear to offset revenues which would be lost under the legislation." Letter from John R. Baldwin, to W. Carey Edwards (May 1, 1984).

⁷⁹ "Economic protectionism" is established upon proof that certain legislation has either a discriminatory purpose or effect. See, e.g. *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978); *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 352 (1977); *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 471 n.15 (1981).

⁸⁰ See *infra* notes 90-108 and accompanying text.

tion of a forty million dollar ethanol facility in Carney's Point, New Jersey is planned.⁸¹ The location of the plant in southern New Jersey is crucial because of the availability of raw materials from local farmers and the easy disposition of the byproduct as a cattle feedstock.⁸² Moreover, the location of the facility may serve to alleviate the pangs of unemployment and overall economic doldrums which have existed in that region over the past few years.⁸³ While northern New Jersey has been successful in attracting new industries, and southeast New Jersey has flourished because of its beaches and casinos, southwest New Jersey has not been as fortunate.⁸⁴ The construction of a new ethanol facility may reverse that trend.⁸⁵ Hundreds of jobs can be created through the construction and continued operation of the facility.⁸⁶ In addition, farmers who previously had difficulty marketing their products will be able to sell their grain to the new ethanol facility.⁸⁷ Conversely, the byproduct of ethanol production can be distributed to local farmers providing a high protein cattle feedstock.⁸⁸ Thus, besides ethanol's positive impact on energy conservation, domestic fuel production, and environmental preservation, ethanol also has attractive economic considerations.

Certainly the Ethanol Exemption Act is vital to New Jersey for a variety of reasons. The Act seeks to further federal energy policy while preserving the environment and strengthening the economy. Moreover, the exemption may serve to draw future producers of ethanol to New Jersey. While these reasons may have motivated the Legislature's action, the Commerce Clause of the United States Constitution⁸⁹ serves as a limitation against such "economic protec-

⁸¹ Interview with Jeff Kramer, Esq., Attorney associated with Ethyl Energy Corp., at his office in Manasquan, New Jersey (Nov. 15, 1984).

⁸² *Id.*

⁸³ *Id.* For example, Cumberland County led New Jersey in unemployment, with a rate as high as 16.4 percent in 1984. Sardella, *Glass Industry Is Cutting Costs to Halt Erosion*, N.Y. Times, Apr. 14, 1984, at 7, col. 1.

⁸⁴ Interview, *supra* note 81.

⁸⁵ *Id.*

⁸⁶ INDUSTRY REPORT, *supra* note 1, at 5.

⁸⁷ Interview, *supra* note 81.

⁸⁸ *Id.*

⁸⁹ U.S. CONST. art. I, § 8, cl. 3, reads:

Congress shall have the power . . . to regulate commerce with Foreign Nations, and among the several States, and with Indian Tribes.

Id.

tionist" legislation. For this reason an analysis of the Ethanol Exemption Act in light of the Commerce Clause is necessary.

Commerce Clause Analysis

Although New Jersey's Ethanol Exemption Act serves substantial state and federal concerns, the constitutional infirmities inherent in the Act threaten its viability. Indeed, similarly constructed statutes in Hawaii, Minnesota, and New York have been unable to meet constitutional challenge.⁹⁰ New Jersey's Ethanol Exemption Act resembles the unconstitutional statutes in the aforementioned states in that it erects a trade barrier to importers of ethyl alcohol by limiting the exemption to in-state producers only. Often referred to as "economic balkanization," legislation akin to New Jersey's has been deemed unconstitutional by the courts.

While an exhaustive treatment of the enigmatic Commerce Clause is beyond the parameters of this Note, a brief overview of the relevant law is in order.⁹¹ According to Alexander Hamilton, the Commerce Clause was enacted to suppress the "interfering and unneighborly regulations of some states" which if not "restrained by national control" would lead to more serious sources of "animosity and discord."⁹² Upon that premise, the Founding Fathers hoped that the national commerce power would eradicate hostile trade restrictions, retaliatory trade regulations, and

⁹⁰ See, e.g. *Bacchus Imports, Ltd. v. Dias*, 104 S.Ct. 3049 (1984) (tax exemption for locally produced Hawaiian liquors); *Archer Daniels Midland Co. v. Minnesota*, 315 N.W.2d 597 (1982) (tax exemption for locally produced gasohol); *Loretto Winery, Ltd. v. Gazzara*, 601 F. Supp. 850 (S.D.N.Y. 1985), *aff'd sub nom*, *Loretto Winery, Ltd. v. Duffy*, Nos. 85-7197, 7205, 7207 *slip op.* at 3731 (2d Cir. May 10, 1985) (alcohol beverage control law for a locally produced wine product).

⁹¹ For an expansive analysis of the Commerce Clause see J. NOWAK, *CONSTITUTIONAL LAW* 166 (1983); L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 326 (1978); Lockhart, *A Revolution in State Taxation of Commerce?*, 65 MINN. L. REV. 1025 (1981); Maltz, *How Much Regulation Is Too Much—An Examination of Commerce Clause Jurisprudence*, 50 GEO. WASH. L. REV. 47 (1981); Shores, *State Taxation of Interstate Commerce—Quiet Revolution or Much Ado About Nothing?*, 38 TAX L. REV. 127 (1982); Comment, *The Constitutional Dilemma of State Tax Exemptions: Sears, Roebuck & Co. v. County of Los Angeles*, 13 GEO. INTER. L.J. 813 (1981); Note, *Commerce Clause Restraints on State Taxation of Energy Resources: A Suggested Framework for Analysis*, 60 WASH. U. L.Q. 425 (1982).

⁹² THE FEDERALIST, No. 22 (A. Hamilton) (Mentor ed. 1961).

protective tariffs on imports from other states.⁹³ Historically, the Supreme Court has unequivocally advocated free trade and competition among the states.⁹⁴

⁹³ See, e.g. *H.P. Hood & Sons v. DuMond*, 336 U.S. 525, 539 (1949). The purpose of the Commerce Clause was interpreted by Justice Jackson, as follows: Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his export, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality. . . .

Id. at 539.

⁹⁴ See, e.g. *Welton v. Missouri*, 91 U.S. 275 (1876) (Missouri license tax applied only to out-of-state peddlers declared invalid); *Guy v. Baltimore*, 100 U.S. 434 (1880) (Maryland wharf tax only to vessels with out-of-state goods held unconstitutional); *Walling v. Michigan*, 116 U.S. 446 (1886) (Michigan tax on persons soliciting out-of-state liquor invalidated); *I.M. Darnell & Son Co. v. Memphis*, 208 U.S. 113 (1908) (Tennessee property tax levied against logs purchased out-of-state was unconstitutional); *Foster-Fountain Packing Co. v. Haydel*, 278 U.S. 1 (1928) (Louisiana statute delaying export of Louisiana shrimp impermissibly burdened interstate commerce); *Baldwin v. G.A.F. Seeling, Inc.*, 294 U.S. 511 (1935) (New York statute excluding milk from Vermont invalid); *H.P. Hood & Sons v. DuMond*, 336 U.S. 525 (1949) (New York law to permit State milk producer to export milk to other states unconstitutional); *Dean Milk Co. v. Madison*, 340 U.S. 349 (1951) (city ordinance requiring local pasteurization of milk invalid); *Halliburton Oil Well Co. v. Reily*, 373 U.S. 64 (1963) (Louisiana tax on the out-of-state assemblage of equipment used in the state invalid); *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970) (Arizona statute which protected Arizona cantaloupes unconstitutional); *Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976) (Mississippi statute excluding out-of-state milk invalid); *Hunt v. Washington State Apple Advertising Comm'n.*, 432 U.S. 333 (1977) (North Carolina statute which discriminated against Washington apples held unconstitutional); *Philadelphia v. New Jersey*, 437 U.S. 617 (1978) (New Jersey statute prohibiting the importation of waste matter from outside the state invalid); *Lewis v. B.T. Investment Managers, Inc.*, 447 U.S. 27 (1980) (Florida statute prohibiting out-of-state investment companies from doing business in the state unconstitutional); *but see Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299 (1851) (Pennsylvania statute requiring local pilots in the port of Philadelphia upheld as within state's police power); *South Carolina Highway Dep't. v. Barnwell Bros., Inc.*, 303 U.S. 177 (1938) (state law which set truck width and weight limitations upheld); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959) (state statutes taxing the net income of doing business in the state upheld); *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976) (statute which made state market participant not violative of Commerce Clause); *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981) (state statute banning sale of milk in plastic containers held not violative of the Commerce Clause). For a more detailed analysis of the Commerce Clause, see J. NOWAK, *CONSTITUTIONAL LAW* 266 (1983); L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 326 (1978); G. GUNTHER, *CONSTITUTIONAL LAW—CASES AND MATERIALS* 257 (10th ed. 1980).

State legislative action, whether in the form of regulations or taxes, is subject to the Commerce Clause.⁹⁵ While the Court has traditionally utilized a variety of formulations in imposing the Commerce Clause limitation upon the states, it has consistently distinguished between "economic protectionism," and indirect burdens on the free flow of trade.⁹⁶ Thus, where a state statute evinces "economic protectionism," the Court has adopted a *per se* rule invalidity.⁹⁷ Where legitimate legislative objectives are advanced and there is no patent discrimination against interstate trade, however, the Court has espoused a more flexible "balancing of interests" approach.⁹⁸ The critical inquiry in these Commerce Clause cases, therefore, is whether particular legislation is a protectionist measure or can be perceived as a law directed to legitimate local concerns with incidental effects upon interstate commerce.⁹⁹

New Jersey's Ethanol Exemption Act can arguably be subjected to either the "economic protectionist" test or the "balancing of interests" test. The Act, an exemption to in-state producers and consumers to stimulate the use of ethanol, could be characterized as a protectionist measure and thus declared in-

⁹⁵ See L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 236-37 (1978).

⁹⁶ *Philadelphia v. New Jersey*, 437 U.S. 617, 623-24 (1978). As Justice Stewart wrote for the Court, "The opinions of the Court through the years have reflected an alertness to the evils of 'economic isolation' and protectionism, while at the same time recognizing that incidental burdens on interstate commerce may be unavoidable when a State legislates to safeguard the health and safety of its people." *Id.*

⁹⁷ *Philadelphia v. New Jersey*, 437 U.S. at 624. See also *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 471 (1981); *Lewis v. B.T. Investment Managers, Inc.*, 447 U.S. 27, 36 (1980).

⁹⁸ See *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970). The Court, in rephrasing the general rule stated:

Where the statute regulates evenhandedly 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 . . . If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Id. at 142. See also *Raymond Motor Transportation, Inc. v. Rice*, 434 U.S. 429, 441-42 (1978); *Hunt v. Washington State Apple Advertising Comm'n.*, 432 U.S. 333, 352-54 (1977).

⁹⁹ *Philadelphia v. New Jersey*, 437 U.S. at 624.

valid *per se*. The Act, however, may be scrutinized under the "balancing of interests" test since legitimate legislative objectives can arguably be advanced. Under this line of reasoning, evidence could be adduced to show the importance of the ethanol industry through energy conservation, environmental preservation, and economic restoration. This argument is bolstered by the incidental effect the Act has upon interstate commerce, since New Jersey imports and sells little, if any, ethanol.¹⁰⁰ Consequently, the constitutionality of New Jersey's legislation could depend upon its classification as a form of "economic protectionism." Should the exemption survive this fatal level of scrutiny, its constitutionality could very well be upheld under the "balancing of interests" approach.

Generally, a state regulation which discriminates against interstate commerce in favor of local business constitutes "economic protectionism" and thus prompts strict judicial scrutiny. Statutes will be subject to this stringent standard of review even though legitimate legislative objectives exist.¹⁰¹ Discrimination in its most obvious form has been found where a regulation has enunciated a discriminatory intent.¹⁰² While encouraging the production and consumption of ethanol is laudable, the New Jersey exemption is expressly limited to ethanol produced in this state. This express limitation may undermine the Act's constitutionality and, under a strict scrutiny analysis, the Act's discriminatory nature could lead to its invalidation.

Though a state regulation may lack a discriminatory purpose, the Court has also struck down statutes which evince a discriminatory effect.¹⁰³ In evaluating the discriminatory effect of a state statute, the Court focuses on the practical, rather than the speculative effect of the state action.¹⁰⁴ The Court has also looked to non-discriminatory or less discriminatory alternatives

¹⁰⁰ See *Alcohol Outlook*, *supra* note 12, at 7. There have been no estimated sales of ethanol in New Jersey. *Id.*

¹⁰¹ See *H.P. Hood & Sons v. DuMond*, 336 U.S. at 534-39 (survey of cases in which the Court invalidated state regulations that were designed to enhance local commerce).

¹⁰² See, e.g. *Philadelphia v. New Jersey*, 437 U.S. 617; *Great A&P Tea Co. v. Cottrell*, 424 U.S. 366.

¹⁰³ See, e.g. *Philadelphia v. New Jersey*, 437 U.S. at 624; *Dean Milk Co. v. Madison*, 340 U.S. at 354.

¹⁰⁴ *Dean Milk Co.*, 340 U.S. at 354.

to achieve the same objective.¹⁰⁵ This analysis, coupled with the evaluation of the regulation's discriminatory impact, has resulted in the Court's "balancing of interests" approach weighing the state's interest in the regulation against the regulation's discriminatory effect upon interstate commerce.¹⁰⁶

Under the "balancing of interests" approach, New Jersey's exemption may be able to pass constitutional muster. The exemption has the obvious effect of placing a more onerous burden upon out-of-state producers by limiting any tax benefit to in-state producers. At present, however, there is no evidence of ethanol being sold in New Jersey.¹⁰⁷ The question then becomes, against whom does this legislation discriminate? While ostensibly the legislation would discriminate against all out-of-state producers, the discriminatory impact would be merely speculative since no ethanol is presently imported. Despite the Act's *prima facie* discrimination against interstate commerce, the practical effect, at present, does not evidence such discrimination. Admittedly, less facially discriminatory alternatives exist. For example, granting the exemption to all ethyl alcohol regardless of its place of origin, would accomplish the purpose of stimulating the utilization of ethyl alcohol motor fuel. Such an across-the-board exemption, however, would not help to make New Jersey competitive with other states, nor help restore the depressed economy in southwest New Jersey. Thus, should the Act survive the strict scrutiny hurdle, it might well be found constitutional under the more flexible "balancing of interests" approach.¹⁰⁸

¹⁰⁵ *Id.*

¹⁰⁶ *See, e.g. Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). *See also supra* note 97 and accompanying text.

¹⁰⁷ *See supra* note 100.

¹⁰⁸ In Commerce Clause challenges of state taxation schemes the court has adopted a four part test. *See Complete Auto Transit v. Brady*, 430 U.S. 274 (1977). Pursuant to this test, a state tax does not offend the Commerce Clause if it is applied to an activity with "a substantial nexus to the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the State." *Id.* at 279. Though involving a tax exemption, New Jersey's ethanol exemption would not be subjected to this four part test. The legislation does not tax, it exempts from taxation. While the state's decision not to tax presumably flows from its taxing authority rather than its police powers, a tax exemption may nevertheless be classified as a regulation for purposes of evaluation. Comment, *The Constitutional Dilemma of State Tax Exemptions: Sears, Roebuck & Co. v. County of Los Angeles*, 13 GEO. U. INTER. L.J. at 835. Indeed, under the four part test only the discrimination against interstate commerce is relevant to the ex-

To understand the application of the Commerce Clause tests, it is necessary to examine cases which have reviewed analogous statutory schemes. Recent federal as well as state court decisions have upheld the basic premise that a state cannot discriminate against interstate commerce.¹⁰⁹ Indeed, New Jersey's law exhibits many of the traits which have been routinely held to constitute unconstitutional commercial restraints. Most apparent is the statute's articulated discriminatory purpose limiting the exemption to in-state producers only. Such *prima facie* discrimination within a statute has had limited success when constitutionally challenged. While the legislative objectives of energy conservation, domestic fuel production, environmental preservation, and economic restoration indubitably support the Legislature's action, the statute's blatant discrimination against out-of-state producers of ethyl alcohol may preclude any consideration of these noble objectives. Support for this conclusion can be gleaned from the fate of three analogous statutes, each held unconstitutional under the *per se* rule of invalidity.¹¹⁰ These cases may serve to portend the ill-fated future of New Jersey's ethanol exemption.

In *Bacchus Imports, Ltd. v. Dias*,¹¹¹ the United States Supreme Court invalidated a Hawaiian liquor tax exemption for locally produced liquor.¹¹² Four liquor wholesalers challenged the constitutionality of the Hawaiian liquor tax¹¹³ which exempted locally produced brandy and fruit wine.¹¹⁴ Enacted by the Hawaii Legislature to encourage the development of the local liquor in-

amination of an exemption. *Id.* at 839. The other three prongs of the test deal with technical features of a tax that obviously do not apply to tax exemptions. *Id.* at 839 n.226. Thus, the exemption would undoubtedly be examined under the Court's traditional Commerce Clause analysis focusing on the statute's discriminatory purpose and effect on interstate commerce.

¹⁰⁹ See, e.g. *Bacchus Imports, Ltd. v. Dias*, 104 S.Ct. 3049 (1984); *Archer Daniels Midland Co. v. Minnesota*, 315 N.W.2d 597 (1982); *Loretto Winery, Ltd. v. Gatzara*, 601 F. Supp. 850 (S.D.N.Y. 1985), *aff'd sub. nom.*, *Loretto Winery, Ltd. v. Duffy*, Nos. 85-7197, 7205, 7207, slip op. at 3731 (2d Cir. May 10, 1985).

¹¹⁰ See cases cited *supra*, note 109.

¹¹¹ *Bacchus Imports*, 104 S.Ct. 3049 (1984).

¹¹² *Id.* at 3057.

¹¹³ HAWAII REV. STAT. § 244-4(6), (7) (1981).

¹¹⁴ *Id.*

dustry,¹¹⁵ the liquor tax exemptions only applied to the production of okolehao brandy¹¹⁶ and pineapple wine.¹¹⁷

The wholesalers' complaint alleged that the tax exemption violated the Import-Export Clause¹¹⁸ and the Commerce Clause¹¹⁹ of the United States Constitution.¹²⁰ Both constitutional claims were rejected by the Tax Appeal Court.¹²¹ On appeal, the Hawaii Supreme Court affirmed.¹²² The United States Supreme Court reversed, concluding that the liquor tax exemptions constituted a violation of the Commerce Clause.¹²³ As Justice White, writing for the Court, noted, "the legislation

¹¹⁵ *Bacchus*, 104 S.Ct. 3055. In examining the Legislature's motivation, the Court relied on the findings of the Hawaii Supreme Court:

The legislature's reason for exempting ti root okolehao from the alcohol tax was to encourage and promote the establishment of a new industry (citation omitted), and the exemption of fruit wine manufactured in the State from products grown in the State was intended to help in stimulating the local fruit wine industry. (citation omitted).

In re *Bacchus Imports, Ltd.*, 65 Hawaii —, 656 P.2d at 730.

¹¹⁶ *Bacchus*, 104 S.Ct. at 3053. Okolehao is a brandy distilled from the root of the ti plant, an indigenous shrub of Hawaii. *Id.*

¹¹⁷ *Id.* Pineapple wine was the only fruit wine manufactured at the time of suit. *Id.*

¹¹⁸ U.S. CONST. art. I, § 10, cl. 2. In pertinent part:

No State shall without the Consent of Congress, lay any Imposts or Duties on Imports or Exports.

¹¹⁹ U.S. CONST. art. I, § 8, cl. 3.

¹²⁰ *Bacchus*, 104 S.Ct. at 3053. In addition, the wholesalers sought a refund of approximately \$45 million, representing all of the liquor tax paid by them for the years in question. *Id.*

¹²¹ *Id.*

¹²² In *Re Bacchus Imports, Ltd.*, 65 Hawaii —, 656 P.2d 724 (1982). The Hawaii Supreme Court also rejected an equal protection challenge. In upholding the statute, the Hawaii Supreme Court held that the exemption was rationally related to the state's legitimate interest in promoting domestic industry and therefore did not violate the equal protection clause. *Id.* at 730. The court further noted that there was no violation of the Import-Export Clause because the tax was applied on all local sales and did not discourage imports in a manner inconsistent with federal foreign policy. *Id.* at 732-33. Finally, the court held that the tax exemption did not illegally discriminate against interstate commerce because the "incidence of the . . . tax is on wholesalers of liquor in Hawaii and the ultimate burden is borne by consumers in Hawaii." *Id.* at 734.

¹²³ *Bacchus*, 104 S.Ct. at 3058. This result was reached despite arguments that the twenty-first amendment saved its unconstitutionality. Wrote the Court, "we are convinced that Hawaii's discriminatory tax cannot stand. Doubts about the scope of the amendment's authorization notwithstanding, one thing is certain: The central purpose of the provision was not to empower States to favor local liquor industries by erecting barriers to competition." *Id.* at 3058.

constitutes 'economic protectionism' in every sense of the phrase."¹²⁴

In its decision, the Court addressed several of Hawaii's arguments which may be of import to New Jersey. First, Hawaii argued that okolehao and pineapple wine do not compete with other products sold by the wholesalers, thus there is no discrimination against interstate trade.¹²⁵ Rejecting this contention, the Court found that the fact that the tax exempt beverages did not pose a "competitive threat" to other liquors was not dispositive.¹²⁶ Rather, according to the Court, the question of whether competition exists only pertains to the extent of the competition.¹²⁷

More importantly, the State urged the Court to employ the "balancing of interests" approach in addressing the exemptions.¹²⁸ In support of this flexible analysis, Hawaii maintained that there was a legitimate legislative objective, no patent discrimination against interstate commerce, and any effect upon interstate commerce was incidental.¹²⁹ The Court, however, did not agree and struck down the statute as "economic protectionism."¹³⁰

"Economic protectionism" is established upon proof that state legislation has a discriminatory purpose or effect.¹³¹ Finding both types of discrimination in Hawaii's tax exemption, the Court stated:

[I]t is undisputed that the purpose of the exemption was to aid Hawaiian industry. Likewise, the effect of the exemption is

¹²⁴ *Bacchus*, 104 S.Ct. at 3057.

¹²⁵ *Id.* at 3054. The state relied on statistics demonstrating that the exempt liquors constituted less than one percent of the total liquor sales. *Id.*

¹²⁶ *Id.* at 3055. One way the statute might compete with other products, the Court noted, "is that drinkers of other alcoholic beverages might give up or consume less of their customary drinks in favor of the exempted products because of the price differential." *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.* "Examination of the State's purpose," wrote Justice White, "is sufficient to demonstrate the State's lack of entitlement to a more flexible approach permitting inquiry into the balance between local benefits and the burden on interstate commerce." *Id.*

¹³¹ *Id.*; see e.g. *Philadelphia v. New Jersey*, 437 U.S. at 624; *Hunt v. Washington State Apple Advertising Comm'n.*, 432 U.S. at 352-53; *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. at 471 n.15.

clearly discriminatory, in that it applies only to locally produced beverages, even though it does not apply to all such products. Consequently, as long as there is some competition between the locally produced exempt products and non-exempt products from outside the State, there is a discriminatory effect.¹³²

Though recognizing the State's ability to enact laws to encourage business pursuant to its police power,¹³³ the Court relied upon the "cardinal rule of Commerce Clause jurisprudence that no state consistent with the Commerce Clause, may impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business."¹³⁴ Hawaii also asserted that a distinction should be drawn between thriving and struggling industries.¹³⁵ Again, the Court did not agree. "The propriety of 'economic protectionism,'" wrote Justice White, "may not be allowed to hinge upon the State's—or this Court's—characterization of the industry as either 'thriving' or 'struggling.'" ¹³⁶ Finally, Hawaii contended that there was no discriminatory intent on the part of the Legislature because the desire was to aid local industry.¹³⁷ The Court also rejected this contention noting, "[i]t is irrelevant to the Commerce Clause inquiry that the motivation of the Legislature was the desire to aid the makers of the locally produced beverage rather than to harm out-of-state producers."¹³⁸ The Court, therefore, concluded that the Hawaii liquor tax exemption was unconstitutional under a Commerce Clause review because it had both the

¹³² *Bacchus*, 104 S.Ct. at 3056.

¹³³ *Id.*

¹³⁴ *Id.* at 3054. *See, e.g.* *Boston Stock Exchange v. State Tax Comm'n.*, 429 U.S. 318, 329 (1977). In *Boston Stock Exchange*, the Court invalidated a New York law that imposed a higher tax rate on stock transfers involving a sale within the state. Thus, the Commerce Clause limits the manner in which states may legitimately compete for interstate trade, for "[i]n the process of competition no state may discriminatorily tax the products manufactured or the business operations performed in any other State." *Id.* at 337.

¹³⁵ *Bacchus*, 104 S.Ct. at 3056.

¹³⁶ *Id.* at 3057.

¹³⁷ *Id.*

¹³⁸ *Id.* The Court recognized that virtually every discriminatory statute allocates the benefits and burdens of the statute unequally, and if Hawaii's argument was accepted there would be little occasion to ever invalidate a statute. The determination of constitutionality does not focus on the benefit or burdened party, but requires a comparison of the two classifications. *Id.*

purpose and effect of discriminating in favor of a local product.¹³⁹

New Jersey's ethanol statute, passed at the time of the *Bacchus* decision,¹⁴⁰ resembles the exemption invalidated in *Bacchus*. Indeed, both statutes provide tax exemptions to locally produced products to encourage their production and consumption.¹⁴¹ Moreover, both statutes manifest *prima facie* discrimination.¹⁴² Based on these grounds and the rationale of the Court in *Bacchus*, New Jersey's legislation appears to be doomed.

The ethanol exemption, however, can be distinguished from the exemption struck down in *Bacchus*. This distinction is based upon the importance of the ethanol industry to the United States.¹⁴³ The Garden State's tax exemption is necessary not only for local concerns, but for national interests as well. In fact, Congress has also provided tax exemptions for alcohol-blend fuel.¹⁴⁴ In addition to the exemption, Congress has included the development of the alcohol-fuel industry in the nation's energy policy.¹⁴⁵ Thus, because the growth of the ethanol industry in New Jersey would help to promote national policy as well as local industry, New Jersey's ethanol exemption may be distinguished from the liquor exemption in *Bacchus*.¹⁴⁶ Based upon this distinction, New Jersey's legislation may be able to withstand constitutional challenge.

Moreover, the New Jersey law can be further differentiated

¹³⁹ *Bacchus*, 104 S.Ct. at 3057.

¹⁴⁰ N.J. STAT. ANN. §§ 54:39-2, 27 (West Supp. 1985-86), was approved as law on July 18, 1984. The Supreme Court's decision in *Bacchus* was handed down on June 29, 1984. *Bacchus*, 104 S.Ct. at 3049.

¹⁴¹ See *supra* notes 60 and 113 and accompanying text.

¹⁴² Both statutes, on their face, limit the exemption to products produced in the state. See *supra* notes 60 and 113 and accompanying text.

¹⁴³ See *supra* notes 1-5 and accompanying text.

¹⁴⁴ See I.R.C. § 4041(K)(1) (1980).

¹⁴⁵ See, e.g. Biomass Energy and Alcohol Fuels Act of 1980, 42 U.S.C. § 8801 (1980). In pertinent part:

[T]he dependence of the United States on imported petroleum and natural gas must be reduced by all economically and environmentally feasible means, including the use of biomass energy resources . . . a national program for increased production and use of biomass energy . . . must be formulated and implemented.

Id.

¹⁴⁶ An additional factor distinguishing New Jersey's legislation is ethanol's relatively positive environmental impact. By providing a cleaner and safer source of fuel power, ethanol and its encouraging exemption might arguably fall within the state's police power.

since unlike Hawaii's exemption, the ethanol exemption is not unique. Indeed, other states have statutes similar to New Jersey's.¹⁴⁷ These states, acting with the purpose of establishing and developing a local ethanol industry, have also limited their exemption to locally produced ethanol.¹⁴⁸ Thus, should New Jersey's statute face constitutional challenge, the inevitable judicial decision could have far-reaching ramifications.

In light of the Court's staunch rejection of Hawaii's contentions, Hawaii's arguments in *Bacchus* would be of little aid in bolstering New Jersey's defense.¹⁴⁹ Hence, despite the fledgling nature of New Jersey's industry and the Act's incidental effect upon interstate commerce, the Court's strong language in *Bacchus* may be dispositive of the success of these arguments.

While New Jersey's statute can arguably be supported in light of the *Bacchus* decision, the Minnesota Supreme Court's holding in *Archer Daniels Midland Co. v. Minnesota*¹⁵⁰ may be a harbinger of doom for New Jersey's law. In *Archer Daniels*, the Minnesota Supreme Court declared unconstitutional a Minnesota statute that exempted locally produced "gasohol" from the excise tax on gasoline.¹⁵¹ Using language similar to that espoused in *Bacchus*, the Minnesota court struck down the statute under the *per se* rule of invalidity.¹⁵²

Minnesota's statute¹⁵³ imposed an excise tax on gasoline, but exempted gasohol from a portion of the tax if the gasohol was produced in Minnesota using Minnesota products.¹⁵⁴ Archer Daniels Midland Company (ADM), the largest gasohol producer in the nation,¹⁵⁵ sought a declaratory judgment to have that section of the

¹⁴⁷ See *supra* note 58.

¹⁴⁸ See *supra* note 58.

¹⁴⁹ See *supra* note 125-140 and accompanying text.

¹⁵⁰ 315 N.W.2d 597 (1982).

¹⁵¹ *Id.*

¹⁵² *Id.* at 599.

¹⁵³ MINN. STAT. § 296.02 (Supp. 1981). The statute, in relevant part provided: [T]he tax on gasoline imposed by subdivision 1 shall be reduced by four cents per gallon for gasoline which is agricultural alcohol gasoline as defined in § 296.01, which is blended by a distributor with alcohol distilled in this State from agricultural products produced in this State. (Emphasis added).

Id.

¹⁵⁴ *Id.*

¹⁵⁵ Archer Daniels, 315 N.W.2d at 598.

statute declared unconstitutional.¹⁵⁶ The district court ordered that portion of the statute stricken which limited the exemption to Minnesota gasohol because it discriminated against interstate commerce.¹⁵⁷ On appeal by the state, the Minnesota Supreme Court affirmed in part and reversed in part.¹⁵⁸

After reiterating the basic tenets of Commerce Clause jurisprudence,¹⁵⁹ the Minnesota Supreme Court held that the gasohol tax exemption was unconstitutional under the *per se* formulation.¹⁶⁰ The statute's provision exempting Minnesota gasohol, wrote the court, "is facial discrimination which openly places a more onerous tax burden upon out-of-state gasohol simply 'because of its origin in another state.'"¹⁶¹ In addition, the court found the statute to be unconstitutional under the balancing of interests test.¹⁶² The statute, the court noted, did not regulate evenhandedly nor serve a legitimate public interest sufficient to justify the burden on interstate commerce but rather "[a]ttempt[ed] to unfairly preserve local markets for local interests by conferring an artificial economic advantage to local interests under the State's taxing power."¹⁶³ The court suggested property tax relief as a less burdensome alternative, and concluded that the Act "[i]mposes a burden on interstate commerce which is clearly excessive in relation to the local benefit."¹⁶⁴

The State contended that the statute was constitutionally valid because the State was acting as a market participant rather than a market regulator.¹⁶⁵ As a market participant, the state argued that

¹⁵⁶ *Id.* at 597.

¹⁵⁷ *Id.* at 598.

¹⁵⁸ *Id.*

¹⁵⁹ *Id.* at 598-99. These principles involve the distinction between protectionism and indirect burdens on the free flow of trade. In essence, where a statute evinces economic protectionism it is invalid *per se*. In contrast, a statute that is facially neutral through even-handed regulation to effectuate a legitimate local public concern is constitutional if the burden imposed upon interstate commerce is not excessive in relation to local benefits. See generally *supra* notes 91-108 and accompanying text for a more thorough examination of Commerce Clause principles.

¹⁶⁰ Archer Daniels, 315 N.W.2d at 599.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* See, e.g. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976). In *Hughes*, the Court upheld the constitutionality of a Maryland statutory scheme whereby the state purchased crushed auto hulks at a premium price in order to rid the state of abandoned autos. Virginia scrap processors claimed that Maryland's

the government may, "[l]ike any other buyer or seller, limit the people with whom it deals."¹⁶⁶ The court, however, refused to accept this contention finding the State to be a market regulator, and thereby invalidating the statute.¹⁶⁷ The court found that the State did not provide for its own purchase of gasohol at a premium price, but burdened out-of-state businesses like ADM with discriminatory taxes.¹⁶⁸ Thus, the Minnesota Supreme Court declared the Act unconstitutional.

The Minnesota Supreme Court, however, refused to strike the unconstitutional language.¹⁶⁹ Because such a remedy would frustrate the legislative intent¹⁷⁰ and provide a windfall to ADM,¹⁷¹ the court subjected all gasohol to the full excise tax.¹⁷² In response to the court's decision, one Minnesota legislator hoped to propose the same exemption with a reciprocity clause to cure the legal defect.¹⁷³ Today, however, Minnesota's statute has been amended and provides the tax exemption to any gasohol producer in the United States.¹⁷⁴ Bolstered by the success in Minnesota, ethanol producers have instituted suits in other jurisdictions challenging ethanol tax

statute violated the Commerce Clause by effectively refusing to purchase out-of-state processed hulks. In upholding the statute, the Court stated, "[n]othing in the purposes animating the Commerce Clause prohibits a State, in the absence of Congressional action, from participating in the market and exercising the right to favor its own citizens over others." *Id.* at 810. Thus, "[t]he Commerce Clause responds principally to state taxes and regulatory measures impeding free private trade in the national marketplace. There is no indication of a constitutional plan to limit the ability of the States themselves to operate freely in the free market." *Reeves, Inc. v. Stake*, 447 U.S. 429, 436-37 (1980).

¹⁶⁶ *Archer Daniels*, 315 N.W.2d at 599.

¹⁶⁷ *Id.* at 600.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* The court found the legislative intent behind the statute was to apply the exemption to Minnesota gasohol only. Thus, if the exemption were applied to local as well as interstate concerns the legislative intent would be frustrated. *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.* The court found ADM to be the largest producer of gasohol in the United States. Hence, without the discriminatory language ADM could reap the benefit of the tax exemption despite the legislative intent. *Id.* Furthermore, the availability of an additional market with an exemption and ADM's volume of sales in Minnesota would preclude the opportunity to establish a local gasohol facility.

¹⁷² *Archer Daniels*, 315 N.W.2d at 600.

¹⁷³ Rep. Dave Fjoslien, the legislator who proposed the exemption, planned to introduce a reciprocity clause to amend the statute. See SOLAR ENERGY REPORT, Vol. 3, No. 5, at 749. An exemption with a reciprocity clause extends the exemption to another state, as long as that state has a similar exemption for gasohol. *Id.*

¹⁷⁴ MINN. STAT. § 296.01, subd. 24 (1983).

exemptions on Commerce Clause grounds.¹⁷⁵ Not all of the gasohol statutes, however, have faced constitutional challenge.¹⁷⁶ Indeed, New Jersey enacted the ethanol exemption aware of the potential constitutional ramifications.¹⁷⁷ Whether New Jersey's statute will be challenged has yet to be determined.¹⁷⁸

While the Minnesota Supreme Court decision is not binding on New Jersey, the decision is of persuasive authority. The statute in New Jersey, like the Minnesota statute, only exempts locally produced alcohol-blend motor fuel. Although the federal government's energy policy was established before the *Archer Daniels* decision,¹⁷⁹ the court, nevertheless, ruled that the discriminatory purpose made the law invalid *per se*. New Jersey's ethanol exemption, however, could technically be distinguished from the statute struck down in Minnesota. First, though the burden on interstate commerce in *Archer Daniels* was great,¹⁸⁰ the burden which results from New Jersey's exemption is minimal because of lower ethanol imports.¹⁸¹ Furthermore, a statutory distinction could be argued because New

¹⁷⁵ See SOLAR ENERGY REPORTS, Vol. 3, No. 5, at 749. Two suits, one in Colorado and one in Louisiana have been brought by ADM. See, e.g. ADM v. McNamara, 544 F. Supp. 99 (D.C. 1982) (lack of jurisdiction under Tax Injunction Act for ADM to challenge statute's constitutionality in federal district court declaratory judgment suit). An additional suit is pending in Florida. Letter memo from Jack M. Skelding, Jr., Esq., to Bob Graham, Governor of the State of Florida (June 14, 1984) (letter memo setting forth the Commerce Clause ramifications of Florida's statute).

¹⁷⁶ See *supra* notes 48 and 175.

¹⁷⁷ Letter from David E. Hallberg, President of the Renewable Fuels Assoc., to Richard Chumney, Director of Division of Rural Resources, Dept. of Agriculture (Nov. 21, 1983) (information on ethanol legislation). In pertinent part: "[w]hile the obvious temptation exists to seek to limit the exemption only to products produced within that State, a number of court cases have found that such limitations are indeed unconstitutional, and should be avoided." *Id.*

¹⁷⁸ N.J. STAT. ANN. § 54:39-2(d) (West Supp. 1985-86), provides for the exemptions to begin October 1, 1985.

¹⁷⁹ The Biomass Energy Alcohol Fuels Act of 1980, *supra* note 15, was well in place in 1982 when the *Archer Daniels* case was litigated. Apparently from the Minnesota court's disposition of the case, the energy policy of the United States was never raised by the State in support/defense of the statute's constitutionality.

¹⁸⁰ See *Archer Daniels*, 315 N.W.2d at 598. ADM shipped in excess of 100,000 gallons of alcohol fuel per month into Minnesota. This alcohol, when blended with gasoline contributed to 85 percent of the gasohol sold in Minnesota. *Id.* ADM did not have a distillation facility in Minnesota nor did ADM use Minnesota products in its distillation process. *Id.* Hence, the burden of interstate commerce due to the exemption was overwhelming.

¹⁸¹ See *Alcohol Outlook*, *supra* note 12, at 7. According to Information Resources, Inc., there have been no estimated sales of alcohol-blend fuel in New Jersey. *Id.*

Jersey's statute, unlike Minnesota's, only limits the exemption to local production.¹⁸² In any case, a defense of New Jersey's statute after the *Archer Daniels* decision would prove difficult at best.

More recently, the traditional tests of Commerce Clause jurisprudence were reaffirmed by the United States Court of Appeals for the Second Circuit.¹⁸³ In *Loretto Winery Ltd. v. Gazzara*,¹⁸⁴ the court struck down as unconstitutional a portion of New York's Alcohol Beverage Control Law.¹⁸⁵ The law provided for the sale of a newly defined "wine product" in retail grocery stores pursuant to a license,¹⁸⁶ a practice not previously allowed in New York State.¹⁸⁷ The constitutional controversy at issue centered around New York's definition of "wine product."

New York's law defined "wine product" as a beverage containing *inter alia*, "wine produced exclusively from grapes grown in New York State and containing not more than six percent alcohol by volume."¹⁸⁸ This "wine product," while not a new invention, was new

¹⁸² N.J. STAT. ANN. §§ 54:39-2, 27 (West Supp. 1985-86).

¹⁸³ *Loretto Winery, Ltd. v. Gazzara*, 601 F. Supp. 850 (S.D.N.Y. 1985), *aff'd sub. nom.*, *Loretto Winery, Ltd. v. Duffy*, Nos. 85-7197, 7205, 7207, slip. op. at 3731 (2d Cir. May 10, 1985). The Second Circuit affirmed Judge Brient's holding that New York's Wine Product Provisions are unconstitutional. The appellate court, however, found "that the New York provisions so clearly run afoul of the Constitution," that they denied the law's enforcement to continue for even sixty days. The court revoked all licenses issued to grocery stores pursuant to New York's statute, and forbid further retail sale of the wine product for use off premises except in licensed liquor stores. The Second Circuit opinion noted that "[i]f the New York Legislature wishes to allow the sale in grocery stores of all wine products, without regard to the origin of the grapes used therein, it may, of course, enact a statute so providing." *Loretto Winery, Ltd. v. Duffy*, Nos. 85-7197, 7205, 7207, slip. op. at 3734 (2d Cir. May 10, 1985).

¹⁸⁴ *Id.*

¹⁸⁵ N.Y. ALCO. BEV. CONT. LAW §§ 3.36-a, 79-a (McKinney 1984).

¹⁸⁶ N.Y. ALCO. BEV. CONT. LAW § 79-a.

¹⁸⁷ *Loretto*, 601 F. Supp. at 852. In New York, wines are generally sold in package stores. The new amendment would allow the additional sale of a "wine product" in retail grocery stores. Since there are 4,500 package stores and 23,000 retail grocery stores, the amendment creates a vast new market for the sale of "wine products." *Id.*

¹⁸⁸ N.Y. ALCO. BEV. CONT. LAW § 3.36-a. The definition of "wine product" in the New York amendments reads as follows:

Wine product means a beverage containing wine produced exclusively from grapes grown in New York State to which is added concentrated or unconcentrated juice, flavoring material, water, citric acid, sugar and carbon dioxide and containing not more than six percentum alcohol by volume, by which nothing other than such wine has been added to increase alcoholic content of such beverage.

to the New York market at this level of alcoholic content.¹⁸⁹ In essence, the statute allowed for the sale of the "wine product" in grocery stores only if made from one hundred percent New York State grapes and not less than six percent alcohol.¹⁹⁰ Grapes grown outside of New York, however, were still subject to the prior restrictions on sales in grocery stores.¹⁹¹ Due to this market discrimination, a constitutional challenge to the statute arose on Commerce Clause grounds.

Plaintiff, Loretto Winery, is a California corporation engaged in the business of producing and selling wine and wine products made substantially from grapes grown in California.¹⁹² Though able to sell its "wine cooler"¹⁹³ in New York package stores, Loretto was prevented from selling its product in New York grocery stores because the New York law required one-hundred percent New York grapes, and Loretto used California grapes in its "wine cooler."¹⁹⁴ This result, Loretto contended, unlawfully discriminated against and unduly burdened interstate commerce in grapes and grape products in violation of the Commerce Clause.¹⁹⁵

Despite New York's argument in favor of the Act's constitutionality,¹⁹⁶ the court invalidated the statute under traditional Com-

Id.

¹⁸⁹ Loretto, 601 F. Supp. at 852 n.3.

¹⁹⁰ N.Y. ALCO. BEV. CONT. LAW §§ 3.36-a, 79-a.

¹⁹¹ Loretto, 601 F. Supp. at 852.

¹⁹² *Id.*

¹⁹³ Loretto's "California Special Wine Cooler" is a wine product containing six percent alcohol and is not chemically different than the newly authorized New York "wine product." Loretto, 601 F. Supp. at 852. Loretto's wine cooler is made from California, not New York, grapes, however. *Id.*

¹⁹⁴ Loretto, 601 F. Supp. at 853.

¹⁹⁵ *Id.*

¹⁹⁶ New York argued that the Act was constitutional and alternatively that the twenty-first amendment saved any unconstitutionality. The amendments to New York's law were designed as an experiment to promote the local wine industry through temperance and convenience; under a system of license and regulation from winery to shelf. Loretto, 601 F. Supp. at 858. However, because of the amendments' discriminatory nature and underinclusiveness it could not survive judicial review. *Id.* Although New York asserted that the twenty-first amendment saved the amendments' constitutionality, the court did not agree. Wrote the court:

More recent cases have demonstrated an unwillingness on the part of the supreme court to allow a state legislature to conduct a trade war against another state, contrary to the principles underlying the commerce clause, simply because the product discriminated against is an al-

merce Clause analysis.¹⁹⁷ Judge Brieant wrote:

Under traditional commerce clause jurisprudence, it is beyond dispute that the ABC Law would be unconstitutional, as discriminatory in both its purpose and its effect. The central purpose of the statutory package was admittedly to promote the sale of "New York labelled wines." This is plain and simple economic protectionism of New York grown grapes, at the expense of out of state grapes and a violation of the commerce clause of the most simple and direct kind.¹⁹⁸

Although the amendment had the additional purposes of experimentation and temperance,¹⁹⁹ its effect was to place out-of-state producers of grapes at a competitive disadvantage by limiting the available market.²⁰⁰ As a result of this discriminatory purpose and effect, the court concluded that "[i]t is clear the interstate commerce clause forbids the state from enacting legislation such as this."²⁰¹

New York asserted that the statute was within the state's police power and was thus constitutional.²⁰² The need for license and regulation of the wine "from winery to shelf" as espoused by the Governor, however, was not included in the amendment by statute or

coholic beverage subject to regulation under the Twenty-First Amendment.

Id. at 860. Thus, New York's ABC law was found to be unconstitutional "in light of the overriding federal interest in free unrestricted trade among the several states which is at stake in this matter." *Id.* at 863.

¹⁹⁷ See *supra* notes 91-108 and accompanying text.

¹⁹⁸ Loretto, 601 F. Supp. at 857-58.

¹⁹⁹ The amendments provided for a sunset date two years after enacted. *Id.* at 858. The six percent alcoholic content was perceived by the court as a move towards temperance. *Id.*

²⁰⁰ The amendments allowed New York wine producers to sell their "wine product" in package stores and grocery stores of which there are a total of approximately 27,500 in New York. Loretto, 601 F. Supp. at 852. Out-of-state producers of a "wine product" not containing 100 percent New York State grown grapes, however, can only market their product through the package stores of which there are an estimated 4,500. *Id.* Thus, local producers have a significant market advantage.

²⁰¹ Loretto, 601 F. Supp. at 859.

²⁰² *Id.* at 857. The state asserted that the amendments were needed to maintain tight control from winery to shelf. The statute, however, does not require the "wine product" come from a New York winery. It only requires that the product contain New York grapes exclusively. Indeed, the statute actually would allow for the shipment of New York grapes to another location for fermentation, blending, and bottling. The product could then be shipped back to New York for sale in package and grocery stores. *Id.* at 858. This underinclusiveness hardly provides for tight control from winery to shelf. *Id.*

application.²⁰³ Indeed, the statute merely required that the product contain New York grown grapes exclusively.²⁰⁴ As such, the legislation did not serve an arguable purpose under the State's police power, and hence no justification for the burden on interstate commerce was presented.²⁰⁵

While the Ethanol Exemption Act is distinguishable from New York's ABC law, the strict statutory and constitutional analysis employed by the New York court in *Loretto* may portend a requiem for the Garden State's legislation. The impetus behind New Jersey's legislation, however laudable, does not pale its discriminatory nature. In light of the decisions in *Bacchus*, *Archer Daniels*, and *Loretto*, a Herculean defense would have to be made in order to withstand a Commerce Clause challenge to New Jersey's statute.

Conclusion

Though the United States is not presently faced with an "energy crisis," the nation's dependence upon foreign oil and petroleum must nevertheless be curtailed now and in the future.²⁰⁶ The ethanol industry in America is contributing to this goal of energy independence. Indeed, federal and state incentives are helping to promote the increased production and consumption of alcohol-blend fuel.²⁰⁷

New Jersey's legislation, like other states, admittedly advances federal energy concerns. In addition, the ethanol exemption arguably serves legitimate local legislative objectives. The establishment of an ethanol facility in New Jersey would raise revenues and provide for employment.²⁰⁸ Moreover, a local ethanol facility can accommodate local farmers by purchasing their corn for feedstock and providing feed supplement from ethanol's by-product.²⁰⁹ New Jersey's statute does, however, present problems as it expressly discriminates against interstate commerce.²¹⁰

²⁰³ *Loretto*, 601 F. Supp. at 858. See *supra* note 202.

²⁰⁴ N.Y. ALCO. BEV. CONT. LAW § 3.36-a.

²⁰⁵ *Loretto*, 601 F. Supp. at 858.

²⁰⁶ See *supra* note 145.

²⁰⁷ See BIOMASS PLAN, *supra* note 15, at 8-9.

²⁰⁸ See *supra* notes 81-86 and accompanying text.

²⁰⁹ See *supra* notes 87-88 and accompanying text.

²¹⁰ See N.J. STAT. ANN. §§ 54:39-2, 27 (West Supp. 1985-86).

Throughout the history of the Commerce Clause, the courts have steadfastly adhered to the policy of free trade and competition.²¹¹ Underlying this policy, the courts' philosophy has been to invalidate a statute which has the purpose and effect of discriminating against interstate commerce.²¹² The Commerce Clause challenges discussed herein never escaped the judiciary's strict level of scrutiny.²¹³ Though legitimate arguments were advanced in these challenges, the courts refused to apply the more flexible "balancing of interests" approach. Due to *prima facie* discrimination neither Hawaii's tax exemption, Minnesota's gasohol exemption, nor New York's alcohol beverage control law could withstand constitutional challenge.²¹⁴

New Jersey's ethanol exemption is dangerously similar to those held unconstitutional in Hawaii, Minnesota, and New York. Under these circumstances, the Legislature could take a "wait and see" attitude. On the other hand, the Legislature might consider an amendment curing the potential constitutional defect prior to adjudication.²¹⁵ Regardless of the action taken, it is important that future producers of ethanol in New Jersey be apprised of the possible ramifications should a Commerce Clause challenge arise.²¹⁶ Though the statute was intended to be a catalyst to industry, it may be found to be unconstitutional as well.

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²¹¹ See *supra* notes 91-108 and accompanying text.

²¹² See *supra* notes 91-108 and accompanying text.

²¹³ *Bacchus*, 104 S.Ct. 3049; *Archer Daniels*, 315 N.W.2d 597; *Loretto*, 601 F. Supp. 850 (S.D.N.Y. 1985), *aff'd. sub. nom.*, *Loretto v. Duffy*, Nos. 85-7197, 7205, 7207 slip. op. at 3734 (2d Cir. May 10, 1985).

²¹⁴ See *supra* note 213.

²¹⁵ On June 27, 1985, Assemblyman Pankok (D.-N.J.) introduced A.3914; a bill to establish an alcohol fuels fund. The bill was assigned to the Agriculture and Environment Committee, and as yet, its effect on the "Ethanol Exemption Act" has not been determined.

²¹⁶ See e.g. SOLAR ENERGY REPORT, Vol. 3, No. 5, at 749. Minnesota Rep. Fjoslien noted that a number of companies have built alcohol-fuel facilities in a particular state due to the tax benefits, only to have the exemption declared invalid thus nullifying any benefit received by the particular location decision. *Id.*