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Court Finds NY Unconstitutionally Shifted Cost of "Opioid Stewardship Fund" to Out-of-State Commerce

by Hyland Hunt

Under the dormant Commerce Clause, "[s]tate laws that discriminate against interstate commerce face a virtually *per se* rule of invalidity." *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2091 (2018). But there is a second set of virtually *per se* invalid laws, too. The dormant Commerce Clause forbids "a state law that has the 'practical effect' of regulating commerce occurring wholly outside that State's borders." *Healy v. Beer Inst.*, 491 U.S. 324, 332 (1989). "[E]xtraterritorial laws disrupt our national economic union just as surely as customs duties." *Carolina Trucks & Equip., Inc. v. Volvo Trucks of N. America, Inc.*, 492 F.3d 484, 490 (4th Cir. 2007) (internal quotation marks omitted).

The difficulty lies in distinguishing between laws that are merely likely to have practical effects in other states (often permissible, so long as they do not "impose undue burdens on interstate commerce," *South Dakota*, 138 S. Ct. at 2091 (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970))), from laws that regulate the conduct of commerce in other states (impermissible). A recent decision from the Southern District of New York in *Healthcare Distribution Alliance v. Zucker*, No. 1:18-cv-6168, 2018 WL 6651682 (S.D.N.Y. Dec. 19, 2018), helps illustrate the distinction. It also shows how a state can discriminate against interstate commerce not only by benefitting in-state businesses and "burdening out-of-state competitors," *Dep't of Revenue of Ky. v. Davis*, 553 U.S. 328, 338 (2008)—classic economic protectionism—but also by engaging in other forms of economic parochialism, including shifting to out-of-state commerce the full costs of a program that benefits only local interests. *Cf. Philadelphia v. New Jersey,* 437 U.S. 617, 628 (1978) (invalidating law that "impose[d] on out-of-state commercial interests the full burden of conserving the State's remaining landfill space").

In *Healthcare Distribution Alliance,* the district court considered New York's Opioid Stewardship Act, which establishes a $600 million "stewardship fund" to pay for efforts to fight opioid addiction. The Act imposes a $100 million annual aggregate assessment on opioid manufacturers and distributors licensed to sell or distribute opioids in New York ("licensees"). *Healthcare Distribution All.*, 2018 WL 6651682, at *3. The amount owed by each licensee is based on the licensee's "ratable share," which in general terms is the ratio of the licensee's New York opioid sales to the total amount of opioids sold in New York in a given year. N.Y. Pub. Health Law § 3323(5). In a pass-through prohibition, the Act provides that "[n]o licensee shall pass the cost of their ratable share amount to a purchaser, including the ultimate user of the opioid, or such licensee shall be subject to penalties…." *Id.* § 3323(2). Under the Act, the New York Health Commissioner is authorized to impose a penalty of up to $1 million per "incident" if "the ratable share, or any portion thereof, has been passed on to a purchaser." *Id.* § 3323(10)(c).

Manufacturers and distributors of generic opioids filed suits challenging the Act. The record before the district court showed that per unit of opioids, the ratable share payment exceeds the average manufacturer

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price of several generic opioids. *Healthcare Distribution All.*, 2018 WL 6651682, at *4. "In other words, on several of the opioids that it manufactures, SpecGx [(a generic drug manufacturer)] has to pay more in assessments … than it makes in margins." *Id.*

After concluding that the Act imposed a fee rather than a tax, and otherwise disposing of New York's motion to dismiss, *id.* at *6-14, the district court turned to the pass-through prohibition and concluded that it impermissibly regulates extraterritorial commerce, *id.* at *17. That conclusion follows from the face of the statute, which places no territorial limitation on the pass-through prohibition (or the associated penalty), even though the Act otherwise "specifically references sales made within New York State" in other provisions. *Id*. A statute that on its face bars manufacturers or licensees from raising prices in Hawaii, New Jersey, or any other state to cover the cost of complying with New York law "directly controls commerce occurring wholly outside the boundaries of [the] State," and effectively "force[s] an out-of-state merchant to seek regulatory approval in one State before undertaking a transaction in another," *Healy*, 491 U.S. at 336-37—for example, through New York's declaration that it does not intend to enforce the Act against out-of-state sales, *Healthcare Distribution All.*, 2018 WL 6651682, at *17. But that sort of direct regulation of out-of-state prices is not within a state's power. *See Healy*, 491 U.S. at 337.

Recognizing that "'every reasonable construction must be resorted to in order to save a statute from unconstitutionality,'" however, the district court did not end its analysis there. *Healthcare Distribution All.*, 2018 WL 6651682, at *17 (quoting *Hooper v. People of State of Cal.*, 155 U.S. 658, 657 (1895)). Instead, the court considered whether the pass-through prohibition was constitutional if limited to sales within New York, and held that even a territorially-limited statute would unconstitutionally discriminate against interstate commerce. *Id.* at *17-18. That is so, the court concluded, because if narrowed to New York, the Act would "discriminat[e] between the purchasers of opioids in New York and those outside it," such that out-of-state purchasers would "bear the cost of New York's policy program." *Id.* at *17-18. The dormant Commerce Clause prohibits "discrimination as to 'any part of the stream of commerce—from wholesaler to retailer to consumer.'" *Id.* at *17 (quoting *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 192 (1994)).

That conclusion is correct, whether analyzed through the lens of extraterritoriality or discrimination. Although it is permissible for a state to seek to achieve the "lowest possible prices for [in-state] consumers," it cannot do so by discriminating against out-of-state transactions. *See Healy*, 491 U.S. at 341. And that is what a no-surcharge-in-New-York rule would necessarily do, especially here, where the record established that the only alternative to imposing a price increase somewhere would be to exit the market entirely. *See Healthcare Distribution All.*, 2018 WL 6651682, at *17. That makes the Act very different from a mere requirement to undertake some costly act (or pay a simple fee), where out-of-state sellers could choose whether or not the requirement had any effect on their out-of-state transactions, and whether to recoup the costs in-state, out-of-state, or both (or not at all). *See, e.g.*, *National Elec. Mfrs. Ass'n v. Sorrell*, 272 F.3d 104, 110-11 (2d Cir. 2001) (addressing state law requiring certain product label). Under the Act, sellers have no choice but to burden out-of-state transactions—and only those transactions—to fund a New York-only program. Even though the regime is not designed to favor in-state producers, it is an example of the same local parochialism that drives economic protectionism. *See C & A Carbone, Inc. v. Clarkstown*, 511 U.S. 383, 393 (1994) ("The Commerce Clause presumes a national market free from local legislation that discriminates in favor of local interests.").

The dormant Commerce Clause is not concerned only with discrimination against out-of-state sellers; it also bars discrimination against (or regulation of) out-of-state transactions. As this case shows, however well-meaning the legislature's intent, it crosses a constitutional boundary to try to lower the cost of solving a local problem by simply exporting that cost to interstate commerce.

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