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Legal Issues in Regulating Imports in State and Regional Cap and Trade Programs

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Legal Issues in Regulating Imports in State and Regional Cap and Trade Programs

Erin Parlar, Michael Babakitis, and Shelley Welton

October 2012

Columbia Law School
Center for Climate Change Law
Michael B. Gerrard, Director

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Executive Summary

As the Regional Greenhouse Gas Initiative (RGGI) undertakes its 2012 program review, participating states have several important decisions to make. One key question is whether to lower the cap that participating RGGI states have set on greenhouse gas emissions (GHGs) to better correspond with changed market conditions that have caused emissions in the region to be lower than predicted. A related consideration is whether to adopt regulations on imported electricity to control for “emissions leakage,” in order to ensure that emissions reduced in the region do not simply spill over into neighboring states and provinces. These two decisions are largely interrelated, as a lower cap is likely to increase the chances that significant emissions leakage might occur. For purposes of this paper, we assume that RGGI states will pursue imports regulations only if they have reason to be concerned that under the revised program, emissions leakage is likely to be a serious problem.

Regulating leakage presents potential legal challenges: in our federal governmental structure, states are limited by the Constitution in the extent to which they can regulate activities occurring beyond their own borders, and may be preempted by federal statutes from regulating certain interstate activities altogether. This paper analyzes the legal hurdles that RGGI may face should it choose to address emissions leakage through regulating imported electricity. It focuses on two legal issues in particular, which are generally thought to be the most likely arguments raised against imports regulations: (1) whether imports regulations violate the dormant Commerce Clause (DCC) of the Constitution; and (2) whether such regulations are preempted by the Federal Power Act (FPA).

Our analysis concludes that imports regulations would likely be ruled constitutional on both counts by a reviewing court. Although the DCC prohibits states from regulating extraterritorially or in a manner that discriminates against interstate commerce, we believe that properly crafted imports regulations are best interpreted as placing only permissible, comparable requirements on imported electricity to those requirements already placed on in-state electricity generators. Although imports regulations would require treating imports slightly differently from in-state emissions for the purposes of monitoring and calculating emissions, these differences would not likely amount to *discrimination* against out-of-state generators as a whole. At most, imports regulations might disadvantage one set of out-of-state generators while advantaging other out-of-state generators. Relevant Supreme Court precedent suggests that state laws that merely shift comparative advantage in this manner are permissible under the DCC.

Moreover, we think it is likely that RGGI could defend imports regulations—if justified by states as necessary to correct for a predicted leakage problem—as bringing participating states benefits that are not outweighed by any incidental burdens placed on out-of-state generators. Finally, we think it is unlikely that a court would strike imports regulations as preempted by the FPA, as these regulations would only incidentally affect the interstate wholesale electricity market and would not impede FERC’s ability to fully carry out its FPA responsibilities.

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INTRODUCTION

Progress in curbing greenhouse gases (GHGs) has been frustratingly slow both internationally and at the federal level in the United States. Many U.S. states have responded by tackling climate change themselves in a range of ways. Most notable are two efforts to create sub-national cap-and-trade programs to regulate GHG emissions. In the northeast, ten states – Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island and Vermont – cooperated to form the Regional Greenhouse Gas Initiative (RGGI) (though one of them, New Jersey, recently dropped out).¹ Collectively, these states have capped and will reduce carbon dioxide (CO₂) emissions from the power sector 10 percent by 2018, relative to the CO₂ allowance budget of 165 million short tons.² California is also implementing a cap-and-trade program, with compliance obligations to begin in 2013, as part of its statewide effort to return the state to its 1990 levels of GHG emissions by 2020.³

These state and regional programs are commendable efforts at regulating an inherently global problem. However, these smaller-scale efforts butt up against a worrisome potential constraint on their effectiveness: the problem of “emissions leakage.” The implementation of a carbon cap on electricity generators within a certain state or region can increase the cost of in-

¹ REGIONAL GREENHOUSE GAS INITIATIVE, <http://rggi.org/rggi> (last visited June 26, 2012). New Jersey was a member of RGGI until 2011, when Governor Chris Christie withdrew the state from the program.

² REGIONAL GREENHOUSE GAS INITIATIVE, http://www.rrgi.org/docs/RGGI_Executive_Summary.pdf (last visited July 10, 2012).

³ See Cal. Air Res. Bd., Resolution 07-55 (Dec. 6, 2007). California is also part of a regional effort to address climate change, the Western Climate Initiative (WCI). However, the WCI has been slower than RGGI to coalesce into a functional program. Although the initiative began in 2007 as a collaboration among Arizona, California, New Mexico, Oregon, and Washington, and expanded to include Montana and Utah as well as the Canadian provinces of British Columbia, Manitoba, Ontario, and Québec, the U.S. states other than California have all halted their collaboration, either formally or informally. See *About the WCI – History*, WESTERN CLIMATE INITIATIVE, <http://www.westernclimateinitiative.org/history> (last visited July 23, 2012). California is now the sole U.S. signatory state moving forward, in collaboration with the participating Canadian provinces.

region electricity generation.⁴ The electric grid, however, does not follow state lines – power can be imported and exported across states. Therefore, when the cost of in-state or in-region generation increases, it may have the effect of causing load-serving entities (LSEs)⁵ within a state to shift their power purchases to uncontrolled and relatively cheaper fossil fuel-fired generation outside of the regulated state or region.⁶ This shift from capped sources to uncapped sources is described as “emissions leakage.”⁷

When designing a state or regional cap-and-trade program, regulators are faced with the question of whether or not to regulate this potential leakage. If left unregulated, it has the potential to undermine the regulated market “by distorting actual emissions levels and providing incentives to shift, rather than reduce, GHG emissions.”⁸ In essence, leakage can mean that the GHG emissions reductions achieved by a policy are lower than intended. However, choosing to regulate leakage has its own challenges: in our federal governmental structure, states are limited by the Constitution in the extent to which they can regulate activities occurring beyond their own borders,⁹ and may be preempted by federal statutes from regulating certain interstate activities altogether.¹⁰

⁴ DAVID FARNSWORTH, CHRISTINA PALMERO & CHRISTOPHER SHERRY, POTENTIAL EMISSIONS LEAKAGE AND THE REGIONAL GREENHOUSE GAS INITIATIVE (RGGI): EVALUATING MARKET DYNAMICS, MONITORING OPTIONS, AND POSSIBLE MITIGATION MECHANISMS 3 (2007) [hereinafter 2007 RGGI REPORT], *available at* http://www.rggi.org/docs/il_report_final_3_14_07.pdf.

⁵ A load-serving entity (LSE) is the “entity that arranges energy and transmission service to serve the electrical demand and energy requirements of its end-use customers. In restructured states, such entities are not necessarily the utilities that own transmission and distribution assets.” REGULATORY ASSISTANCE PROJECT, *ELECTRICITY REGULATION IN THE U.S.: A GUIDE* 112 (2011).

⁶ 2007 RGGI REPORT, *supra* note 4.

⁷ *Id.*

⁸ SNULLER PRICE ET AL., ENERGY AND ENVTL. ECON., INC., *ELECTRICITY LEAKAGE ANALYSIS SUMMARY REPORT* 5 (2009).

⁹ U.S. CONST. art. I, § 8, cl. 3.

¹⁰ *See, e.g.* the Federal Power Act, which reserves the power to regulate the interstate transmission and sale of electricity to the Federal Energy Regulatory Commission. 16 U.S.C. §§ 791-823 (2006).

Faced with these competing concerns, RGGI and California have, so far, proceeded down opposite paths. RGGI requires electricity generators in participating states of greater than 25 megawatts (MW) to purchase one allowance for each ton of carbon dioxide that they generate. During its program design phase, RGGI chose to regulate only in-region generators, placing no cap on emissions associated with electricity imported into the RGGI states from out-of-region generation. This decision raised some concern over the possibility that leakage might offset a large portion of RGGI's emission reductions.¹¹ However, during RGGI's first three years of operation, leakage appears not to have posed a significant a problem.¹² This has been largely attributed to the imposition of a cap much higher than actual emissions,¹³ which has depressed allowance prices and thereby kept in-region generation relatively competitive with out-of-region generation.¹⁴ RGGI is now in the middle of its 2012 program review, where it is considering, among other issues, whether to tighten its cap.¹⁵ If RGGI tightens the cap to correspond with actual emissions levels, allowance prices (i.e., the fee for CO₂ emissions) would be expected to increase, thereby increasing the probability of leakage. Under these circumstances, regulating leakage would become much more important.

¹¹ Jonathan B. Wiener, *Think Globally, Act Globally: The Limits of Local Climate Policies*, 155 U. PA. L. REV. 1961, 1969-70 (2007) [hereinafter *Think Globally*] (citing *The Magnificent Seven: States Take the Lead on Global Warming*, GRAPEVINE ONLINE, Jan. 17, 2006, <http://www.aceee.org/about/0601rggi.htm>).

¹² *NYISO: RGGI Has Not Caused GHG Increases in Nonparticipating States from Increased Imports*, POWERNEWS, Oct. 19, 2011, <http://www.powermag.com/POWERnews/4115.html>; see also James T. Gallagher, *NY Wholesale Electricity Markets & the Effect of RGGI on Imports*, REGIONAL GREENHOUSE GAS INITIATIVE (Oct. 11, 2011), http://www.rggi.org/docs/ProgramReview/LearningSession1/Presentation_James_Gallagher_NYISO.pdf.

¹³ *RGGI At One Year: An Evaluation of the Design and Implementation of the Regional Greenhouse Gas Initiative*, ENVIRONMENT NORTHEAST 3-4 (Feb. 2010), http://www.env-ne.org/public/resources/pdf/ENE_2009_RGGI_Evaluation_20100223_FINAL.pdf. The cap was originally set higher than the historical emissions of member states because of assumptions that have subsequently proved inaccurate. In particular, a steep decline in emissions has been attributed to low natural gas prices and the economic downturn.

¹⁴ Committee Report, *Report of the Climate Change & Emissions Committee*, 31 ENERGY L.J. 571 (2010).

¹⁵ REGIONAL GREENHOUSE GAS INITIATIVE, PROGRAM REVIEW, http://www.rggi.org/design/program_review/ (last visited July 23, 2012)

California, on the other hand, has chosen to regulate leakage by placing compliance obligations on electricity imported into the state as well as generated in the state.¹⁶ California likely chose to regulate leakage from the inception of its program due to the overwhelming problem experts predicted it would otherwise face: Californians import about one-quarter of the electricity they consume, and these imports are “disproportionately dirty, accounting for over half of the CO₂ credited to California electricity demand.”¹⁷ California’s imports regulations have not yet faced a legal challenge, but many anticipate that as the program moves from planning to implementation, challenges will be mounted.

As RGGI considers whether to adopt imports regulations for its program moving forward, it may hesitate due to worries over the legality of any such scheme. This paper analyzes the legal hurdles that RGGI may face should it choose to address emissions leakage through regulating imported electricity. For purposes of this paper, we assume that RGGI would proceed with imports regulations only if it tightened its cap or otherwise amended the program such that emissions leakage became a more prominent concern.¹⁸ We make this assumption because imports regulations would be harder to justify as a necessary component of RGGI if there were no worry that emissions leakage was, in fact, occurring or likely to occur.¹⁹

¹⁶ We discuss the design of California’s imports regulations in more detail *infra* Part I. California regulators were in fact *required* to select a program design to “minimize leakage” by the state’s comprehensive climate change bill, AB 32: California Global Warming Solutions Act of 2006.

¹⁷ JAMES BUSHNELL, CENTER FOR THE STUDY OF ENERGY MARKETS, THE IMPLEMENTATION OF CALIFORNIA AB 32 AND ITS IMPACT ON WHOLESALE ELECTRICITY MARKETS 5 (University of California Energy Institute, 2007), available at <http://www.hks.harvard.edu/hepg/Papers/Bushnell.pdf>

¹⁸ Although RGGI would not need to show a *past* leakage problem in order to justify adopting regulations to protect against leakage, RGGI would want to at least be able to demonstrate via modeling or other research that emissions leakage was likely to present concerns under a revised scheme.

¹⁹ Of course, states might want to enact imports regulations irrespective of worries over leakage due to fairness concerns about the relative competitiveness of in-state and out-of-state firms. Our analysis does not consider whether stand-alone imports regulations, adopted without any reforms to RGGI that would increase the potential for leakage, would withstand a legal challenge. In that case, the dormant Commerce Clause analysis would differ from the one presented here, in that the regulations could not be justified as necessary to maintain the environmental effectiveness of the cap-and-trade program.

This white paper focuses on two legal issues that are generally thought to be the most likely arguments raised against imports regulations: (1) whether imports regulations violate the dormant Commerce Clause (DCC) of the Constitution; and (2) whether such regulations are preempted by the Federal Power Act (FPA). Based on the analysis that follows, we believe that the imports regulations being considered by RGGI would likely be ruled constitutional on both counts by a reviewing court.

Part I of this paper assesses potential design options for regulating GHG emissions associated with electricity imported into the RGGI region. Part II analyzes the potential DCC hurdles that each of these approaches may face. Part III examines any potential claims that challengers may bring under the FPA. Finally, Part IV discusses a few additional legal issues unique to Canadian imports that should be considered during the design phase of imports regulations.

I. DESIGN OPTIONS FOR MITIGATING LEAKAGE

We first examine the key design issues important to consider when drafting leakage regulations. There are numerous ways to attempt to minimize leakage by reducing electricity load, particularly through energy efficiency policies.²⁰ Reduced demand helps keep cap-and-trade compliance costs low, which “reduce[s] the generation cost differential between electric generators subject to a carbon cap and those that do not face a carbon constraint, which is

²⁰ Such mechanisms include conservation efforts, energy efficiency portfolio standards, building energy codes and standards, appliance and equipment energy efficiency standards, combined heat and power systems, carbon procurement adders, carbon procurement emissions rates, and emissions portfolio standards. For more information on these indirect leakage control mechanisms, *see* 2007 RGGI REPORT, *supra* note 4, at 1; *see also* CAL. AIR RES. BD. FOR THE STATE OF CAL., CLIMATE CHANGE SCOPING PLAN (2009) [hereinafter CARB SCOPING PLAN], *available at* http://www.arb.ca.gov/cc/scopingplan/document/adopted_scoping_plan.pdf; COLUMBIA LAW SCHOOL CENTER FOR CLIMATE CHANGE LAW, PUBLIC UTILITY COMMISSIONS & ENERGY EFFICIENCY: A HANDBOOK OF LEGAL AND REGULATORY TOOLS FOR COMMISSIONERS & ADVOCATES (August 2012), *available at* (forthcoming; link should be available by the time paper is finalized) (cataloguing tools that state public utilities commissions can utilize to promote energy efficiency).

expected to mitigate potential leakage.”²¹ However, if regulators decide that these indirect means of helping to alleviate leakage are insufficient to deal with the scope of the leakage problem a state or region faces, then a focus on imports is necessary. Imports regulations assign compliance obligations to in-state providers of electricity purchased from beyond state borders that are similar to those obligations imposed on electricity generated in-state. There are two main design options that have been proposed to regulate imports: the First Jurisdictional Deliverer (FJD) approach, and the load-based cap approach.

These two approaches differ primarily in the point at which the regulation is taking place. Where along the supply chain is the point of compliance for the enforcement of GHG reductions? Under an FJD approach, compliance obligations are placed on whoever first delivers electricity into the state or region’s grid, be it an in-state generator, an LSE importing power, or a wholesale marketer importing power. In contrast, under a load-based cap, the compliance obligation for imports is placed solely on LSEs, which are assigned the emissions from imports that they purchase.²² In practical terms, the choice to place the obligation on FJDs or LSEs does not raise distinct legal challenges, but it might make a difference in terms of how easy it is for RGGI to monitor and regulate the system. The details of these two approaches are described in turn below.

a. First Jurisdictional Deliverer Approach

Under an FJD framework, responsibility for emissions arising from imported electricity is assigned to those entities that first import power into the regulated region. These entities would be labeled as “importing firms.”²³ Conceptually, the FJD approach is a regulatory expansion of a

²¹ 2007 RGGI REPORT, *supra* note 4, at 27.

²² BUSHNELL, *supra* note 17, at 7.

²³ *Id.* at 2.

source-based approach to regulating GHG emissions. In-state or in-region generators are still responsible for their own emissions, as with a traditional cap-and-trade system.²⁴ The FJD simply adds an additional layer of regulated entities to cover those emissions associated with imports.

California is the only example of how the FJD approach might be implemented in practice. Its regulations define a “first jurisdictional deliverer” or “first deliverer” as “the operator of an electricity generating facility in California or an electricity importer.”²⁵ In other words, the “FJD” is either an in-state generator or the first entity that delivers imported electricity into California over which the state has regulatory authority.²⁶ The “importer” of electricity can be identified for each transaction of electricity by information gathered from North American Electric Reliability Corporation (NERC) e-Tags, which are used by NERC to track load and monitor transactions of electricity as it is scheduled to flow across parts of the country.²⁷ “Electricity importers” can be divided into two categories: (1) electric utilities, or “retail providers,” including LSEs, which use the imports for their own power supply;²⁸ and (2) wholesale power “marketers,” which supply electricity in the spot market.²⁹ The regulations thereby place compliance obligations on the entity with title to electricity at the point of *delivery*

²⁴ *Id.*

²⁵ CAL. CODE REGS. tit. 17 § 95802(a)(103), available at <http://www.arb.ca.gov/regact/2010/capandtrade10/finalrevfro.pdf>.

²⁶ California Air Resources Board, *Including Imported Electricity in a California Cap-and-Trade Program* 8 (2009), <http://www.arb.ca.gov/cc/capandtrade/meetings/060509pm/presentation.pdf>.

²⁷ CAL. CODE REGS. tit. 17 § 95802(a)(170).

²⁸ Utilities may or may not physically own transmission assets, and their ownership of such assets is beside the point for purposes of imports regulations. Utilities are defined as “importers” for that power which they contractually purchase on behalf of their end-use customers, irrespective of whether they also own the transmission lines over which the power is transported into the state. *See supra* note 5.

²⁹ *See* CAL. CODE REGS. tit. 17 § 95802(a)(87). Wholesale power marketers are those entities that buy wholesale power from generators and resell it to retail entities for consumption by consumers. These marketers may or may not physically own any generation, transmission, or distribution assets. *See What is a Wholesale Electricity Market?*, Electric Power Supply Association, at <http://www.epsa.org/industry/primer/?fa=wholesaleMarket> (last visited Aug. 6, 2012).

into California, irrespective of what entity owns the transmission capacity that the imported electricity is moving across. As applied to first deliverers, California's cap-and-trade scheme requires both electric utilities and wholesale power marketers to obtain a sufficient number of allowances to cover the emissions associated with load supplied by these entities to Californians, from out-of-state generators.

In order to successfully implement an FJD approach to address leakage, a regulator needs to be able to track and monitor two key pieces of information: 1) the amount of electricity that is imported into and consumed within the state or regulated region,³⁰ and 2) the GHG emissions associated with those imports. While pre-existing NERC regulations allow California to monitor load being imported into and consumed within the state, the state needed an additional mechanism for attributing GHG emissions to particular loads. Thus California created a distinction between "specified" and "unspecified" transactions of electricity.³¹ Specified transactions are typically comprised of bilateral contracts between out-of-state generators and in-state electricity providers where a delivery path and the parties can be identified. Since the generating plant is known, it is relatively easy to assign emissions to load being served into California. On the other hand, unspecified transactions reflect load imported into the region where it is unclear specifically where the power originated. Under these circumstances,

³⁰ This also necessitates being able to differentiate between electricity that is consumed within the regulated region and electricity that is "wheeled through" the region in order to serve demand elsewhere. California monitors – but does not regulate – electricity that travels through the state but is consumed elsewhere and excludes this electricity from reported imports and exports. GREENHOUSE GAS REPORTER TRAINING ELECTRIC POWER ENTITIES, CALIFORNIA AIR RESOURCES BOARD 39 (Apr. 26, 2012), *available at* http://www.arb.ca.gov/cc/reporting/ghg-rep/tool/power_regreqs_1page.pdf.

³¹ See CAL. CODE REGS. tit. 17 § 95802(a)(264) ("Specified Source of Electricity" or "Specified Source" means a facility or unit which is permitted to be claimed as the source of electricity delivered."); *id.* at § 95802(a)(278) ("Unspecified Source of Electricity" or "Unspecified Source" means electricity generation that cannot be matched to a specific electricity generating facility or electricity generating unit or matched to an asset-controlling supplier recognized by ARB. Unspecified sources contribute to the bulk system power pool and typically are dispatchable, marginal resources that do not serve baseload.").

California makes certain modeling assumptions about generation and related emissions in neighboring power systems and develops a “default emissions rate” that it attributes to unspecified load. Under California’s default assumptions, all unspecified imports are assigned a regional default emission factor of 1,100 pounds of CO₂e/MWh produced,³² regardless of the geographic region from which the electricity is imported.³³ This default factor is determined based on a range of assumptions about what types of sources do, and do not, supply power into wholesale markets.³⁴

b. Load-Based Approach

The main alternative to the FJD approach is to adopt a “load-based” approach to regulating imports. Under this approach, the LSE, rather than the importer, is the point of imports regulation. In other words, the main distinction between an FJD and a load-based approach is that under the former, compliance obligations for imports attach to those “first deliverers” over which the state or region exercises jurisdiction – a larger set of entities than just LSEs. There is no functioning example of a state regulating imports through the load-based approach. However, there have been recommendations that RGGI look closely at the load-based approach as the method perhaps best suited to its geographical and technical situation.

³² CO₂e, or CO₂ equivalent, is “the concentration of CO₂ that would cause the same amount of radiative forcing as a given mixture of CO₂ and other forcing components.” NATIONAL ACADEMY OF SCIENCES, CLIMATE STABILIZATION TARGETS: EMISSIONS, CONCENTRATIONS, AND IMPACTS OVER DECADES TO MILLENNIA 11 (2011).

³³ PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, FINAL OPINION ON GREENHOUSE GAS REGULATORY STRATEGIES 54 (2008), *available at* http://docs.cpuc.ca.gov/word_pdf/FINAL_DECISION/92591.pdf.

³⁴ For reference, this value is significantly lower than the average emission factor of 2,249 lbs CO₂/MWh from coal-fired generation in the United States and even a little less than that of all natural gas facilities, which comes in at 1,135 lbs CO₂/MWh. UNITED STATES ENVIRONMENTAL PROTECTION AGENCY, CLEAN ENERGY, <http://www.epa.gov/cleanenergy/energy-and-you/affect/air-emissions.html> (last visited July 10, 2012). However, it is slightly greater than the average emissions factor of new combined cycle natural gas (NGCC), which “emits the least amount of CO₂ and does so at the least cost.” Standards of Performance for Greenhouse Gas Emissions for New Stationary Sources, 77 Fed. Reg. 22,392, 22,398 (proposed Apr. 13, 2012) (to be codified at 40 C.F.R. pt. 60), *available at* <http://www.regulations.gov/#!documentDetail;D=EPA-HQ-OAR-2011-0660-0001>. NGCC facilities are expected to easily meet the 1,000 lbs CO₂/MWh new source performance standard currently being proposed by the EPA. *Id.* at 22,399 (“the proposed standard of performance in today’s rulemaking . . . is based on the emission rate of a new NGCC unit”).

Under the load-based approach, LSEs are assigned the emissions of the out-of-state sources from which they purchase power.³⁵ Similar to first deliverers under California’s FJD approach, LSEs have to acquire and surrender CO₂ allowances in an amount that reflects the CO₂ content of the energy that they purchase. Therefore, as in an FJD scheme, regulators must be able to track both quantities of imports and the emissions associated with those imports.

A load-based approach faces the same challenge as an FJD approach in determining the emissions associated with particular imports, as not all electricity imports are traceable to a specific source; in many cases, an LSE can trace its purchase only to a wholesale power system. Therefore, a load-based approach also requires adopting some sort of assumptions about system emissions—which we will call an “emissions factor”—to attach to imported energy. For purposes of this paper, we assume that RGGI states, in coordination with their independent system operators (ISOs) and regional transmission organizations (RTOs), could achieve the technical capabilities necessary in order to be able to track specifically (a) imported energy that would be subject to RGGI’s cap-and-trade program, i.e. coming from fossil-fuel fired generation 25 MW and larger;³⁶ and (b) the emissions attributes associated with out-of-region specific generators and system power, including the assignment of an “emissions factor” to unspecified imports.³⁷

³⁵ BUSHNELL, *supra* note 17, at 8.

³⁶ We assume that in order to treat in-region and out-of-region generation as evenly as possible, RGGI will only regulate power coming from out-of-region generators that are greater than 25 MW in size (as in-region generators below this size are exempted from RGGI regulations).

³⁷ “Out-of-region power” includes load being imported into the RGGI region from Canadian provinces. In order to avoid any constitutional issues associated with emissions data collection, it will be important that ISOs/RTOs not impose direct obligations on out-of-state generators to report emissions to regulators. Emissions data should be available for U.S. electricity imported into the RGGI region; more challenging is the question of how RGGI could obtain the emissions data necessary to track imports’ emissions and calculate an “emissions factor” for Canadian imports. While the technical issues of how to obtain such data are beyond the scope of this paper, we did want to note that such data would need to be obtained cooperatively, rather than through imposing any extraterritorial reporting obligations, in order to avoid constitutional problems.

c. Resource Shuffling

Under either an FJD or load-based imports regulation scheme, the important additional issue of limiting the potential for gaming the system must be addressed. In particular, imports regulations are potentially subject to manipulation through what experts have termed “resource shuffling.”

As mentioned earlier, the United States is served by a network of interconnected interstate electrical grids, where electrons can flow in complex paths that make tracing them back to a particular source impossible.³⁸ Accordingly, the use of bilateral electricity contracts, where a specified source sells to a specified buyer, is in a way sort of fiction: the paper contract creates an obligation for the source to supply a certain amount of electricity to the grid, and a right for the buyer to remove this same amount from the grid, but the same electrons are not necessarily added and removed by these two parties.

This physical reality creates the potential for gaming through “resource shuffling.” Resource shuffling refers to the incentives created by imports regulations for out-of-state generators to “shuffle” the assignment of existing sources so that those sources with relatively lower emissions are assigned to a regulated region, in order for suppliers to comply with a carbon cap. In exchange, relatively dirtier sources that used to serve load in the regulated region are “shuffled” to meet demand elsewhere.

Recall that under either an FJD or load-based approach, imports either are treated as “specified” and therefore as coming from a particular source, or “unspecified” and assigned an “emissions factor.” This design naturally creates a tendency for importers to try to achieve “specified” status for all of their imports that have emissions below the level of the emissions

³⁸ H. Joseph Drapalinski, *The Viability of Interstate Collaboration in the Absence of Federal Climate Change Legislation*, 21 DUKE ENVTL. L. & POL’Y F. 469, 481 (2011) (quoting *Think Globally*, *supra* note 11, at 1969).

factor associated with the system. Out-of-state generators that hold a mix of generating assets, some cleaner and some dirtier than the system average, may therefore contractually assign their clean power as being sold to LSEs or importers in a regulated state or region, while assigning more carbon-intensive power to fully out-of-region sales.³⁹ An electricity supplier can thereby give the appearance that it is supplying clean power into a regulated region *without actually changing its emissions profile at all*. Since resource shuffling can severely undermine the goals of a regime aiming to reduce GHG emissions, adopting regulations to prevent it is a critical element of a successful cap-and-trade scheme.

In California, the California Air Resources Board designed rules to counteract this threat, including explicitly prohibiting resource shuffling in its regulations.⁴⁰ It has also limited out-of-state sources' ability to engage in "specified" contracts with FJDs. California's regulations allow an FJD to claim that the power it is importing comes from a specified source only if 1) the source has historically exported to California, 2) the source is a hydropower facility that is federally owned or otherwise allocated by contract with the federal government, or 3) generation is being imported from new facilities or new capacity at existing facilities. If the contract in question fails to meet one or more of these exceptions, then load served under its terms will be labeled as "unspecified" and assigned the default emissions rate.⁴¹

³⁹ 2007 RGGI REPORT, *supra* note 4, at 41.

⁴⁰ CAL. CODE REGS. tit. 17, §95852(b)(1), *available at* <http://www.arb.ca.gov/regact/2010/capandtrade10/candtmmodreg.pdf>.

⁴¹ It is worth noting that Commissioner Philip D. Moeller, of the Federal Energy Regulatory Commission (FERC), recently wrote to California's Governor Brown to express concern that California's resource shuffling regulations are not precise enough, and asked California to suspend enforcement of its prohibition on resource shuffling until its rules are clarified. *See* Letter from Commissioner Philip D. Moeller to the Honorable Edmund G. Brown, August 6, 2012, *available at* <http://www.ferc.gov/about/com-mem/moeller/moeller-08-06-12.pdf>. In response, CARB decided to suspend for eighteen months the portion of its regulations requiring an annual attestation that importers have not engaged in resource shuffling during the previous year. During this time, CARB plans to engage in additional rulemaking to define "the types of conduct or transactions that would trigger a finding of resource shuffling." Letter from CARB Chairman Mary D. Nichols to the Honorable Philip D. Moeller, August 16, 2012, *available at* <http://www.arb.ca.gov/newsrel/images/2012/response.pdf>. The primary implication of this recent exchange for

A similar resource shuffling prohibition would be necessary in a load-based scheme. Otherwise, out-of-state generators could engage in the same kind of resource shuffling in their contracts with LSEs as they might with FJDs, shifting contractual assignments so that it appeared that RGGI was being served by clean resources without actually changing generation mix. If RGGI adopted a load-based scheme, it would therefore almost certainly want to supplement this scheme with resource shuffling regulations. In practice, these regulations would likely closely resemble California's rules, requiring LSEs to apply an emissions factor to unspecified contracts, with further rules allowing specified contracts only to exist when the imports can be shown to come from a historical contract path, the creation of a new facility, or the expansion of existing facilities.

II. DORMANT COMMERCE CLAUSE

With this background in place, we now turn to an examination of the primary topic of this paper: the legal issues that RGGI's adoption of some form of the above-described imports regulations might raise. The first and most important issue is the extent to which imports regulations might violate the dormant Commerce Clause. Second, and in our opinion of less concern, is the extent to which imports regulations might encroach upon the federal government's jurisdiction over interstate transmission of electricity and wholesale electricity markets, as provided by the FPA (addressed in Part III). Finally, we briefly address potential issues raised by regulating the cross-border transmission of electricity between RGGI states and Canada (Part IV).⁴²

RGGI is that if RGGI states should choose to pursue imports regulations, they should consider how to build in adequate specificity to give regulated entities and FERC confidence in precisely what the rules prohibit and permit.

⁴² We do not consider in this analysis whether individual RGGI states have the legal authority, under existing state legislation, to pass regulations combating leakage.

a. Overview of the Doctrine

The Commerce Clause grants Congress the power “[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.”⁴³ The Commerce Clause has long been interpreted to contain a negative component, the so-called “dormant” Commerce Clause, which limits states’ ability to impose burdens on interstate commerce.⁴⁴

Courts take several steps when determining whether a state law comports with the dormant Commerce Clause. First, the court considers whether a statute or regulation is either facially or effectively discriminatory against out-of-state interests. If so, the court applies a strict scrutiny test when evaluating that law’s constitutionality. Separately, the court will also examine whether a law regulates extraterritorially. If it does, the law will be invalidated. If a law is not discriminatory and does not regulate extraterritorially, the court applies the more lenient *Pike* balancing test in deciding whether the law is constitutional. The Supreme Court has also carved out an exception to the dormant Commerce Clause, providing that a statute will be upheld if it functions by placing the enacting State in the role of a market participant. The following subsections describe each of these analytical steps in more detail.

1. Discrimination and Extraterritorial Regulation

The first question asked by a court conducting a dormant commerce clause analysis is whether the law at issue discriminates against out-of-state interests, “either on its face or in practical effect.”⁴⁵ If so, such a law is considered “virtually *per se*” invalid.⁴⁶

“Discrimination” in this context refers to “differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.”⁴⁷ In order to be

⁴³ U.S. CONST. art. I, § 8, cl. 3.

⁴⁴ *See, e.g.,* Dept. of Revenue of Ky. v. Davis, 553 U.S. 328, 337 (2008).

⁴⁵ *See* Maine v. Taylor, 477 U.S. 131, 138 (1986).

⁴⁶ *Davis*, 553 U.S. at 338.

discriminatory, a statute must afford this differential treatment to “substantially similar entities.”⁴⁸ This is because, without such similarity, it is entirely possible that two entities would continue to serve different markets absent the allegedly discriminatory burden.⁴⁹ The challenger bears the initial burden of demonstrating that a statute is discriminatory.⁵⁰ When a court does find discrimination, “the *extent* of the discrimination . . . is of no relevance to the determination whether a State has discriminated against interstate commerce,” at least in the context of a facially discriminatory statute.⁵¹

The key inquiry in determining whether a statute is discriminatory is whether it operates to effect economic protectionism in favor of in-state interests.⁵² Outright bans on imports generally fail under this test, as do laws that create obvious preferences for in-state entities. For example, in *City of Philadelphia*, the Supreme Court held that a statute that banned the importation of out-of-state waste was both facially and effectively discriminatory.⁵³ The Court ruled that New Jersey could not preserve its landfill space by overtly discriminating against an article of commerce (the out-of-state waste) based solely on its origin.⁵⁴ Likewise, in *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine*, the Court held that a law that provided more favorable tax treatment to a nonprofit church camp primarily serving intrastate clientele, than to those camps primarily serving interstate clientele, was facially discriminatory.⁵⁵ The Court reasoned that this differential treatment created a burden that ultimately fell on out-of-

⁴⁷ *Or. Waste Sys., Inc. v. Dep’t of Envtl. Quality of State of Or.*, 511 U.S. 93, 99 (1994).

⁴⁸ *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 298 (1997).

⁴⁹ *Id.* at 299.

⁵⁰ *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979).

⁵¹ *Wyoming v. Oklahoma*, 502 U.S. 437, 455 (1992).

⁵² *City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978).

⁵³ *Id.* at 627.

⁵⁴ *Id.* at 629.

⁵⁵ 520 U.S. 564 (1997).

staters, deterring them from enjoying the benefits of camping in Maine, and was thus discriminatory.⁵⁶

Once a statute is determined to be discriminatory, courts apply what is nominally referred to as a “strict scrutiny” standard in evaluating that statute.⁵⁷ In order to survive, a state must justify the law in terms of legitimate “local benefits” and the “unavailability of nondiscriminatory alternatives” that would effectuate the statute’s goals.⁵⁸ Courts uphold statutes subject to this level of scrutiny in only the rarest of circumstances.⁵⁹ One of the few times the Supreme Court has upheld a discriminatory statute was in *Maine v. Taylor*.⁶⁰ In that case, Maine had enacted a statute prohibiting the importation of live baitfish.⁶¹ The Court acknowledged that this ban facially discriminated against interstate trade.⁶² Nevertheless, the Court upheld the statute because a parasite common to out-of-state baitfish could disrupt Maine’s ecology, and there was no way to effectively test live baitfish for this parasite.⁶³ Thus, the Court held that although the statute was discriminatory, Maine had a reason distinct from that of origin to treat out-of-state baitfish differently than in-state baitfish.⁶⁴

A law may also be struck down if it is deemed an extraterritorial regulation and therefore impermissible.⁶⁵ A statute is considered an extraterritorial regulation when it applies to commerce occurring entirely outside of the enacting state’s borders, even if that commerce has

⁵⁶ *Id.* at 581 (1997).

⁵⁷ *See, e.g., Or. Waste Sys., Inc. v. Dep’t of Envtl. Quality of State of Or.*, 511 U.S. 93, 101 (1994).

⁵⁸ *Hunt v. Wash. State Apple Adver. Comm’n*, 432 U.S. 333, 353 (1977).

⁵⁹ *See, e.g., Or. Waste Sys.*, 511 U.S. at 101.

⁶⁰ 477 U.S. 131 (1986).

⁶¹ *Id.* at 132.

⁶² *Id.* at 138.

⁶³ *Id.* at 141, 151.

⁶⁴ *Id.* at 152.

⁶⁵ *See, e.g., Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989).

effects within the enacting state as well.⁶⁶ In deciding whether the effect of a statute is extraterritorial regulation, the Court considers the consequences of the statute itself and the effects that would arise if many states adopted similar legislation.⁶⁷ A state *specifically* may not require an out-of-state merchant to seek approval in one State before engaging in a transaction in another or adopt legislation which, in effect, establishes a price-scale in other states.⁶⁸ Extraterritorial regulations are *per se* invalid, regardless of whether this reach beyond the state's borders was intended.⁶⁹

An illustrative example of an impermissible extraterritorial regulation is the statute at issue in *Brown-Forman Distillers Corp. v. N.Y. State Liquor Authority*.⁷⁰ The New York law at issue in *Brown-Forman* required any distiller or agent who wished to sell alcoholic beverages to a wholesaler in the state to file a price schedule.⁷¹ That schedule would take effect in the second month after filing, and all sales made during the applicable month were required to be at the prices specified therein.⁷² The law also required any distiller or agent who filed a price schedule to affirm that the prices contained therein were no higher than the lowest price at which the item was being sold in any other state during the month the schedule was in effect.⁷³ Thus, the law prevented distillers from lowering prices of liquor in other states while the posted price in New York was in effect.⁷⁴ The Court found this law unconstitutional because it effectively regulated

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.* at 336-37.

⁶⁹ *Id.* at 336.

⁷⁰ 476 U.S. 573 (1986).

⁷¹ *Id.* at 575.

⁷² *Id.* at 575-76.

⁷³ *Id.* at 576.

⁷⁴ *Id.* at 579-80, 582-83.

the price of sales occurring entirely outside of New York, and required distillers to seek New York's approval in order to conduct wholly out-of-state sales as they wished.⁷⁵

2. Pike Balancing

When a statute is determined not to be discriminatory or to effectuate extraterritorial regulation, but burdens interstate commerce, an evaluating court applies the more lenient standard articulated in *Pike v. Bruce Church, Inc.*⁷⁶ The *Pike* test provides that a statute with some effect on out-of-state commerce may be upheld so long as it 1) regulates even-handedly, 2) effectuates a legitimate local public interest, 3) affects interstate commerce only incidentally, and 4) does not impose a burden on interstate commerce that is clearly in excess of the putative local benefits.⁷⁷ “State laws frequently survive this *Pike* scrutiny, . . . though not always.”⁷⁸ The *Pike* inquiry is extremely fact intensive, not easily susceptible to generalization. This paper will explore the *Pike* balancing test as it specifically applies to leakage regulation in Part II(b)(iii).

3. Market Participant Exception

Finally, it is worth noting that the Supreme Court has carved out an exception to the dormant Commerce Clause in those instances where a state acts as a market participant. As it has explained, “[n]othing in the purposes animating the Commerce Clause prohibits a State . . . from participating in the market and exercising the right to favor its own citizens over others.”⁷⁹ As such, a state participating in the interstate market may choose not to deal with other parties as it sees fit.⁸⁰ The market participant exception, however, would not come into play during a challenge to imports regulations, as it only is implicated when the state itself is acting as a

⁷⁵ *Id.* at 582-83.

⁷⁶ 397 U.S. 137 (1970).

⁷⁷ *Id.* at 142.

⁷⁸ *Dept. of Revenue of Ky. v. Davis*, 553 U.S. 328, 339 (2008).

⁷⁹ *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810 (1976).

⁸⁰ *South-Central Timber Dev. v. Wunnicke*, 467 U.S. 82, 94 (1984).

commercial entity.⁸¹ In the case of RGGI states choosing to regulate imports, the states would not be acting as market participants, but rather imposing regulatory requirements on certain commercial transactions occurring within their borders. *Some* of the entities on whom compliance obligations would be placed might be able to claim market participant status, as in the case of municipal utilities like the Long Island Power Authority in New York.⁸² However, the fact that states might be acting as “market participant with respect to one portion of a program while operating as a market regulator in implementing another” would not be enough to save imports regulations from a dormant Commerce Clause challenge.⁸³ And imposing compliance obligations on state-owned entities alone would not accomplish the goal of fully preventing leakage, and would likely be politically unattractive. Accordingly, we do not believe that the market participant exception would provide a full and valid defense to a dormant Commerce Clause challenge to imports regulations, and for that reason we do not discuss the exception in further detail.

b. Dormant Commerce Clause Application

We now consider whether RGGI states can adopt imports regulations while also conforming to the requirements of the dormant Commerce Clause. In order to conduct this analysis, we make some basic assumptions about the type of imports regulations that RGGI might adopt. First, while it is uncertain if RGGI will decide that the appropriate point of regulation is LSEs or FJDs, we believe that the distinction is largely irrelevant for Commerce Clause purposes. Even though some FJDs are closer than LSEs to out-of-state entities in the

⁸¹ See, e.g., *South-Central Timber Dev. v. Wunnicke*, 467 U.S. 82, 96 (1984) (explaining that the exception only extends as far as the “continuing proprietary interest” a state retains during a commercial relationship).

⁸² See Kelley A. Karn, Note, *State Electric Restructuring: Are Retail Wheeling and Reciprocity Provisions Constitutional?*, 33 IND. L. REV. 631, 648 (2000) (noting that “[i]t is possible that a municipal utility could . . . be exempt from a Commerce Clause attack as a market participant”).

⁸³ See *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 438 F.3d 150, 157-58 (2d Cir. 2006), *aff'd*, 550 U.S. 330 (2007).

chain of commerce, this distinction does not speak to the practical effect the regulations would have on interstate commerce.

We assume that irrespective of which entity it chooses to regulate, RGGI will apply an emissions factor to all unspecified energy provided to either FJDs or LSEs. This could be applied uniformly to all imports—as is the case in California—or it could be more narrowly calculated to account for imports coming from different regions with different generation mixes and thus emissions rates. This distinction may implicate certain dormant Commerce Clause issues, as discussed below. We further assume that, in order to prevent resource shuffling, all energy provided by out-of-state generators will be deemed “unspecified” with the exceptions of energy procured based on a historical agreement with an out-of-state source, from a new energy source, or from incremental capacity at an existing energy facility.⁸⁴ Finally, we assume that RGGI states will maintain their current method of source-based emission caps on electricity generated in-state.⁸⁵

We believe that the regulation of resource shuffling—via application of a system-based emissions factor and limitations on specified contracts—is the most contentious element of imports regulations for dormant Commerce Clause purposes, and will thus focus the majority of our analysis on that issue. For the sake of brevity, we will refer to the use of a system-based emissions factor coupled with limited specified contracts as “resource shuffling regulations” for the remainder of this analysis.

It may also be helpful to say a word up front about who the potential challengers to any resource shuffling regulations might be. In general, the most likely aggrieved parties are out-of-

⁸⁴ As explained in more detail *supra* page 13-14, “unspecified” imports are those that are purchased from a system, as opposed to an individual unit—or are deemed by regulation to come from an unspecified source in order to prevent resource shuffling—and are therefore subject to the emissions factor.

⁸⁵ See *supra* p. 2

region generators whose exports to the RGGI states would be subject to new regulations, or more precisely, the consumption of whose product is regulated within an adjacent state. Although all out-of-region generators might object, certain types of generators might have greater grounds for objection: any out-of-region generator whose generation portfolio was *cleaner* than the emissions factor applied to it, but who did not have historical specified contracts, might protest that it was being disadvantaged by having the emissions factor applied to its RGGI exports. Finally, states that are exporters to the RGGI region and whose generators might face a decrease in the amount of power that RGGI LSEs decide to import might also find reasons to object.

Ultimately, as we explain below, we believe any challenges would likely prove unsuccessful. Because these hypothetical resource shuffling regulations would not involve any transactions occurring entirely out-of-state, a court would probably not find them unconstitutional as an extraterritorial regulation. We likewise believe that a court would find that these regulations do not discriminate against out-of-state commerce, as they impose a cost on FJDs or LSEs who import electricity that is comparable to the cost already imposed on in-state generators subject to RGGI's cap-and-trade system. If this is correct, and a reviewing court ultimately applied the *Pike* balancing test to these regulations, we believe that, since the regulations do not present burdens disproportionate to their benefits and would not obviously result in a shift in demand from out-of-state electricity to in-state electricity, a court would uphold the regulations as a constitutionally valid exercise of state power.

1. Imports regulations should survive an extraterritoriality challenge.

To be invalidated as an extraterritorial action in violation of the dormant Commerce Clause, a statute typically must regulate activity that is not at all occurring within its own

borders.⁸⁶ As the point of compliance for RGGI’s resource shuffling regulations would be either FJDs or LSEs – in-state entities in either situation –it is unlikely that a court would characterize the regulations as occurring “wholly outside of the State’s borders.”⁸⁷ Out-of-state generators would not be required to alter their practices in any way as a result of these regulations. As such, the regulations could not legitimately be characterized as regulating wholly out-of-state transactions.

Perhaps the strongest—though probably ultimately unavailing—argument in favor of extraterritoriality is that RGGI, by regulating imports, would impermissibly be trying to regulate how out-of-state entities go about producing electricity. This position might find support in the recent Eastern District of California decision in *Rocky Mountain Farmers Union v. Goldstene*.⁸⁸ There, the court invalidated the state’s low carbon fuel standard (LCFS) on several grounds, including the fact that it interpreted the regulation as controlling conduct occurring wholly outside of California by grading imported fuels based on a range of components that include farming practices, harvesting practices, and “land use change” scores.⁸⁹ The court reasoned that because “the aim of the LCFS is to change these practices to reduce GHG emissions,” the regulation impermissibly attempted to “control conduct beyond the boundary of the state.”⁹⁰

We are unconvinced that this particular interpretation of the extraterritoriality doctrine is correct or applicable to RGGI imports regulations. In the extraterritoriality examples we presented earlier, state regulations had a *direct* impact on out-of-state conduct, for example by controlling when and at what levels prices could be set in other states. This type of

⁸⁶ See, e.g., *Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989).

⁸⁷ *Id.* (quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 642 (1982) (plurality opinion))

⁸⁸ No. CV-F-09-2234, 2011 WL 6934797 (E.D. Cal. Dec. 29, 2011).

⁸⁹ *Id.* at *13.

⁹⁰ *Id.* (quoting *Healy*, 491 U.S. at 336-37).

extraterritorial effect is quite different from the attenuated incentives that RGGI imports regulations would provide. At most, by requiring LSEs or FJDs to purchase GHG allowances to account for the emissions associated with the energy they import, resource shuffling regulations would impact the *price* that LSEs/FJDs might be willing to pay for particular types of out-of-region power. However, it is well established that a “[m]ere ‘upstream pricing impact’ is not a violation of the dormant Commerce Clause, even if the impact is felt out-of-state where the stream originates.”⁹¹ This upstream pricing effect alone therefore should not cause a court to invalidate resource shuffling regulations.

The Supreme Court has also invalidated state laws as extraterritorial regulations when those affected activities could be subjected to inconsistent regulations if many states adopted similar legislation.⁹² On this point, out-of-state generators might argue that RGGI imports regulations would subject them to the laws of RGGI states in addition to their home states. This argument ignores the fact that out-of-state generators will themselves face *no compliance obligations* under either an FJD or load-based imports regulation scheme—all obligations will fall either on in-region FJDs or LSEs.

The more pertinent question, then, is whether FJDs or LSEs might be subject to inconsistent regulations if many states adopted similar legislation. The strongest argument against the regulations that might be mounted here is that a wholesale power marketer or utility serving customers in multiple states might face different compliance obligations in each state, to the extent that states outside of RGGI decided to adopt similar regimes. However, this fact alone is not likely enough to create a risk of inconsistent obligations—to the contrary, utilities

⁹¹ Freedom Holdings, Inc. v. Cuomo, 624 F.3d 38, 67 (2d Cir. 2010) (alteration in original) (quoting Freedom Holdings, Inc. v. Cuomo, 592 F. Supp. 2d. 684, 707 (S.D.N.Y. 2009)).

⁹² See CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 88 (1987).

operating in multiple states already face considerable regulatory burdens in each one that are not uniform. The fact that other states might also adopt cap-and-trade regulations with imports obligations would not create *inconsistent* obligations because an LSE or FJD would never be subject to multiple regulations *for the same power*. Because RGGI would only regulate power being consumed within the RGGI region, and no state outside the RGGI region could constitutionally impose requirements on power consumed inside RGGI, there is no real risk of inconsistent obligations. Although LSEs or FJDs might face different imports compliance obligations in different states (and right now, even this possibility is a distant hypothetical), there does not seem to be a likelihood that the obligations created would be inconsistent, such that RGGI states would be “project[ing] [their] legislation into other States.”⁹³

2. Resource shuffling regulations are likely not discriminatory.

Since resource shuffling regulations would not likely be invalidated based on the extraterritorial reach doctrine, a court would next consider whether RGGI’s regulatory scheme is discriminatory on its face, in purpose, or in effect.⁹⁴ In order to be discriminatory, a law must

⁹³ *Brown-Forman Distillers Corp. v. N.Y. Liquor Auth.*, 476 U.S. 573, 583-84 (1986) (finding a risk of inconsistent regulations where New York’s price regulations on liquor created the distinct possibility that another state would have to abandon or modify its laws). The *Brown-Forman* court specifically found that a recent “proliferation” of similar state statutes “greatly multiplied the likelihood” of inconsistent obligations, and was able to identify specific ways in which state obligations might conflict -- a situation quite distant from the one faced by RGGI, where surrounding states do not appear close to adopting similar regulations. *Id.*

On the other hand, the district court in the recent decision invalidating California’s low carbon fuel standard did find a possibility of inconsistent obligations, even though no other states had adopted standards. *See Rocky Mtn. Farmers Union v. Goldstene*, No. CV-F-09-2234, 2011 WL 6934797, at *16 (E.D. Cal. Dec. 29, 2011). There, the court reasoned that California’s rules, if adopted widely, would cause the ethanol market to become “Balkanized, since a producer would have a strong incentive to either relocate its operations in the State of largest use, or sell only locally to avoid transportation and other penalties.” *Id.* at *15. The same Balkanization argument would be more difficult to make in the case of electricity, given the nature of the good and its ability to flow freely between states. Nor would generators or FJDs be forced to physically alter their product to comply with different state laws in potentially problematic ways, *see id.*, because all that is required for RGGI compliance is the purchase of appropriate numbers of allowances, not physical alterations to a product.

⁹⁴ *Maine v. Taylor*, 477 U.S. 131, 138 (1986); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984). Courts *will* consider a statute’s text, context, legislative history, and whether it is tailored to the asserted legislative goal, in order to try and discern its purpose. *Family Winemakers of Cal. v. Jenkins*, 592 F.3d 1, 13 (1st Cir. 2010). However, statutes are typically invalidated when they discriminate on their face or in effect, presumably because these types of

burden out-of-state entities and benefit in-state entities that are similarly situated.⁹⁵ In the context of resource shuffling regulations, those similarly situated entities would presumably be in-state and out-of-state generators. A challenger would thus bear the burden of demonstrating that out-of-state generators face hurdles not comparably levied upon in-state generators that wish to serve the relevant state's electricity market.⁹⁶ This burden must functionally evince economic protection in favor of those in-state interests.⁹⁷

The sorts of regulations which have most commonly been ruled discriminatory are those which either explicitly reserved part of a market for in-state interests,⁹⁸ banned imports or exports of goods,⁹⁹ or enacted differential tax schemes on in-state and out-of-state interests for the benefit of the former.¹⁰⁰ The most blatant of these violations, a flat ban on imports, is not at issue here. What is at issue is the fact that only out-of-state generators would have their emissions subject to resource shuffling regulations, including assumptions about a system's emissions factor and limitations on what contracts could be "specified." However, as explained below, because application of an emissions factor is intended only to ensure that imports are treated *comparably* to in-state generation sources, we believe it is unlikely that a court would find resource shuffling regulations discriminatory.

discrimination more obviously contravene the goal of preventing "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Or. Waste Sys., Inc. v. Dep't of Env'tl. Quality of State of Or.*, 511 U.S. 93, 99 (1994). In order to avoid a finding of discriminatory purpose, RGGI states would need to avoid characterizing their regulatory goals as import prevention. Still, the closely related inquiries into facial and effective discrimination will probably be of more practical relevance to any dormant Commerce Clause challenges that might be raised. As long as the statute's stated purpose is along the lines of providing a system to fully account for a state's GHG footprint, the "purpose" prong of discrimination should be a non-issue.

⁹⁵ *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 298 (1997).

⁹⁶ *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979).

⁹⁷ *City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978).

⁹⁸ *Wyoming v. Oklahoma*, 502 U.S. 437, 455 (1992) (reserving a portion of the coal-fired electric market for in-state coal).

⁹⁹ *City of Philadelphia*, 437 U.S. at 627 (banning the importation of out-of-state waste).

¹⁰⁰ *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 265 (1984) (providing a tax exemption to certain locally produced alcoholic beverages).

i. Resource shuffling regulations treat in-state and out-of-state electricity generation comparably.

Challengers will likely argue that making FJDs or LSEs responsible for emissions associated with their out-of-region electricity purchases based on emissions factor assumptions would disincentivize interstate commerce. In perhaps the most relevant precedent supporting this position, *Healy v. Beer Institute*, the Supreme Court considered a Connecticut statute that required out-of-state beer shippers to post monthly statewide wholesale beer prices and to affirm that their posted prices were, at the moment of posting, no higher than the prices they charged in neighboring states.¹⁰¹ The Court invalidated this statute on multiple grounds, including the fact that it was facially discriminatory because it applied only to interstate brewers or shippers, creating a disincentive for companies doing business in Connecticut to also engage in the interstate market.¹⁰² However, successfully analogizing resource shuffling regulations to the sort of disincentive-effect described in *Beer Institute* would not be straightforward.

If a court viewed resource shuffling regulations as an attempt to force in-state purchases, it might prove fatal to the regulations.¹⁰³ But such an interpretation of imports regulations would be a mischaracterization, for several important reasons. First, it is not clear that resource shuffling regulations would in fact deter FJDs or LSEs from importing electricity. Certainly, such rules would not deter FJDs or LSEs from entering into permissible specified contracts with out-of-state generators that have relatively clean emissions profiles, as this generation might well be cheaper than in-region generation subject to the RGGI cap.

¹⁰¹ 491 U.S. 324, 326 (1989).

¹⁰² *Id.* at 341.

¹⁰³ *See C & A Carbone, Inc. v. Town of Clarkstown, New York*, 511 U.S. 383, 392 (1994) (explaining that a law which required all solid waste leaving a particular town be processed at a specific facility prevented out-of-state processors from serving the town's demand for waste processing).

Of course, per design, FJDs and LSEs would face an additional administrative burden when importing power, given that they would have new obligations to purchase RGGI allowances to cover associated emissions (whereas under RGGI's current design, LSEs are not burdened with any compliance obligations, which are placed solely on in-state generators). Nevertheless, this purposeful change in incentives hardly amounts to the kind of scheme invalidated in *Healy*, because there would be no more freedom accorded to in-state electricity contracts than to out-of-state ones.

RGGI states' strongest argument against allegations of discrimination stems from the existing cap on GHG emissions imposed on in-state generators. It cannot be overemphasized that the central goal of the dormant Commerce Clause is to prevent *economic protectionism*.¹⁰⁴ In *City of Philadelphia*, using reasoning similar to that later employed in *Beer Institute*, the Court struck down a ban on waste imports because it believed that New Jersey was attempting to isolate itself from the interstate economy and impose the full burden of conserving landfill space on out-of-state commercial interests.¹⁰⁵ The Court refused to allow New Jersey to solve its own problems at the expense of other states.¹⁰⁶ This logic does not extend to resource shuffling regulations. Far from attempting to impose full burdens out-of-state, RGGI states have *already* implemented caps on in-state generators' GHG emissions. But in-state obligations are not alone sufficient to reduce the carbon footprint of participating RGGI states—resource shuffling regulations are one necessary piece of the regulatory puzzle in order to ensure that RGGI achieves its environmental objectives.

¹⁰⁴ *City of Philadelphia*, 437 U.S. at 624.

¹⁰⁵ *Id.* at 628.

¹⁰⁶ *Id.*

If challengers argue that resource shuffling regulations should be viewed in isolation of the existing limits placed on in-state generators, Supreme Court precedent will not support their position. In *West Lynn Creamery, Inc. v. Healy*, the Court considered a regulatory regime in which all Massachusetts milk dealers (both in-state and out-of-state companies) were required to pay a non-discriminatory tax, and in-state producers of milk were granted a subsidy.¹⁰⁷ The Court granted Massachusetts its premise that both the tax and the subsidy were independently constitutional,¹⁰⁸ yet refused to “analyze separately two parts of an integrated regulation.”¹⁰⁹ Just as the Court viewed Massachusetts’ regulatory regime holistically in order to find it unconstitutional, it should also be willing to consider the entire scope of RGGI’s regulations. Despite any initial appearance that resource shuffling regulations are discriminatory against out-of-state generators, when considered within the existing scheme of source-based regulations already in place, a court should recognize that no such discrimination in fact exists.

RGGI states will find additional support for this holistic approach in the Supreme Court’s compensatory tax doctrine. Under this line of cases, “a facially discriminatory tax that imposes on interstate commerce the equivalent of an identifiable and substantially similar tax on intrastate commerce does not offend the negative Commerce Clause.”¹¹⁰ In order to qualify, the tax must be imposed on “substantially equivalent event[s].”¹¹¹ It is a matter of some dispute whether RGGI itself is a “tax”; although this issue was raised in recent litigation in New York state court, the case was dismissed for lack of standing and the issue was not reached.¹¹² But RGGI need not be characterized as a tax in order to gain persuasive authority from the compensatory tax

¹⁰⁷ 512 U.S. 186, 190-91 (1994).

¹⁰⁸ *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 (1994).

¹⁰⁹ *Id.* at 201.

¹¹⁰ *Associated Indus. of Mo. v. Lohman*, 511 U.S. 641, 647 (1994) (internal quotation marks omitted).

¹¹¹ *Id.* (alteration in original) (quoting *Maryland v. Louisiana*, 451 U.S. 725, 759 (1981)).

¹¹² *Thrun v. Cuomo*, Slip. Op. No. 4358-11, at *4-6 (N.Y. Sup. Ct. June 12, 2012).

doctrine. The doctrine's underlying justification—that it is acceptable to make interstate commerce bear the same level of burden as intrastate commerce¹¹³—should buttress the contention that imports regulations are permissible because they impose substantially equivalent requirements on in- and out-of-region electricity.

Opponents of import regulations may advance the argument that even taken as a whole, the burden upon interstate commerce exceeds that imposed on intrastate commerce, which is fatal under the compensatory tax doctrine.¹¹⁴ They would point out that while in-state generators are subject to a cap on emissions and must themselves purchase allowances, they can sell as much electricity as they wish to FJDs or LSEs, without the *purchasing entity* having to fulfill any compliance obligations. Thus, they may argue that imports regulations make it more difficult for out-of-state generators to sell electricity to RGGI-regulated FJDs or LSEs.

RGGI states could best combat this point by arguing that even though the obligations are different, the end result is a GHG-based limitation on electricity generation, accomplished through slightly different, but comparable, mechanisms. Even granting that in-state generators would have an easier time completing the actual sale of electricity, they would have a more difficult time generating the electricity in the first place, since they are subject to direct compliance obligations. Thus, the ultimate effect of both the in-state source-based cap and the allowance obligations imposed on FJDs or LSEs is to burden generators at equivalent levels. Furthermore, the reality is that since all compliance obligations related to the resource shuffling regulations would fall on either FJDs or LSEs, out-of-state generators would not in fact face any new obligations at the point of sale. They could, at most, face a decrease in demand due to the indirect pricing implications of the FJD/LSE mandate to purchase GHG allowances in tandem

¹¹³ See *Associated Indus.*, 511 U.S. at 647.

¹¹⁴ See *id.* at 648.

with imported electricity—an equivalent effect to the one already felt by in-state generators who must purchase allowances accounting for their own emissions.

As discussed previously, part of RGGI’s attempts to prevent resource shuffling may include limiting those instances when imported electricity can be classified as “specified” and account for its unit-specific emissions instead of having an emissions factor applied.¹¹⁵ If RGGI chooses to limit specified status to imports that are from historical relationships, incremental generation capacity at existing facilities, and new facilities, its member states may face the challenge that a comparable qualification is not present for in-region generators. Again, this challenge ignores the very real limitations placed on in-state generators in the form of capped GHG emissions and specific reporting requirements. Because the interaction between existing source-based regulations and the proposed resource shuffling regulations results in a comparable hindrance on electricity purchases, a court would probably not find that the resource shuffling regulations were discriminatory.

Two words of caution, though: first, a court’s willingness to find resource shuffling regulations non-discriminatory may hinge to some degree on the effects that the application of a system-based emissions factor would have on out-of-state generators. The use of an emissions factor will necessarily subject some out-of-state generators to assumptions about their emissions levels that are higher than their actual emissions levels (for that power that these generators sell through the wholesale market, rather than through specified contracts).¹¹⁶ These generators may argue that subjecting them to these harmful assumptions amounts to discrimination, given that

¹¹⁵ See *supra* pp. 10-12.

¹¹⁶ It is not clear to us how many generators might in fact be harmed by having an emissions factor applied. Only those out-of-state generators that currently sell into the wholesale market, rather than through bilateral contracts, and that have cleaner generation profiles than the average profile in their region, would be harmed. It might be useful for RGGI to gain an understanding of how many generators fall into this category.

in-state generators report their actual emissions and therefore are not subjected to these same potentially harmful assumptions.

We do not believe this feature should doom imports regulations. Because the emissions factor would necessarily be an *average* of the emissions in a system, a proportional number of out-of-state generators would benefit from having the emissions factor applied. Such a shift in comparative advantage among out-of-state firms is not enough to constitute discrimination against interstate commerce. The Supreme Court has clearly held that the dormant Commerce Clause “protects the interstate market, not particular interstate firms.”¹¹⁷ Accordingly, “[t]he fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce.”¹¹⁸ Based on this precedent, the use of an emissions factor appears unlikely to lead to a finding of discrimination.

However, the more that the emissions factor assumptions appear grossly unfair to certain market participants, the more willing a court *might* be to view the emissions factor assumptions as discriminating against out-of-staters, given that in-state firms are not subjected to any similar assumptions. Thus, to the extent that certain systems differ greatly in their average emissions, RGGI would be wise to apply a specific emissions factor to each system, rather than use one default factor as California has done. Use of a more tailored method to calculate emissions factor might be viewed as creating more justifiably proportionate in- and out-of-state obligations.¹¹⁹ RGGI should also characterize these systems as accurately as possible, and update assumptions periodically.

¹¹⁷ Exxon Corp. v. Governor of Maryland, 437 U.S. 117, 127-28 (1978).

¹¹⁸ *Id.* at 126.

¹¹⁹ However, under a more tailored approach, cleaner generators within regions that ended up with “dirtier” emissions factors would perhaps find even more cause to object. But again, a burden imposed on particular out-of-state generators to the benefit of other out-of-state generators should not amount to discrimination. *See id.*

Second, it will be important to pay attention to advancements in GHG regulations in states outside of RGGI that sell power into the RGGI region.¹²⁰ If a state abutting the RGGI region adopts its own cap-and-trade requirements, then power imported from that state would be double-regulated if RGGI failed to account for the regulatory requirements placed on that state's electric generators. To a certain extent, this problem is easily solved by following the lead of California, which allows allowances from approved, linked jurisdictions to count for compliance with its scheme.¹²¹ We recommend that RGGI consider providing similar opportunities for exemption from its scheme when electricity is imported from a generator subject to what RGGI determines to be a comparable cap-and-trade system in its home state, or find some alternative method of properly accounting for the existence of an out-of-region cap-and-trade program.

Perhaps more complicated is the question of what to do in those situations where an out-of-region generator is subject to *some* GHG compliance obligations in its home state, but something that falls short of an equivalent cap-and-trade scheme. Generators in this situation might justly assert that to require RGGI LSEs to cover the full value of their emissions would discriminate against them as compared to RGGI generators, who would be able to sell power more cheaply because they would not be subject to dual compliance obligations in and out of RGGI. At this point, a situation along these lines appears purely hypothetical, as no state selling into RGGI has a firm GHG reduction obligation imposed on its generators.¹²² Nevertheless, RGGI might consider building some flexibility into any imports scheme to help deal with this problem should it arise in the future. Perhaps some sort of variance or credit could be granted to

¹²⁰ The same is true of Canadian provinces, as discussed *infra* Part IV.

¹²¹ See CAL. ADMIN. CODE tit. 17, § 95940 et seq.

¹²² An out-of-state generator might attempt to argue that state energy efficiency policies or renewable energy policies amount to GHG regulations that should receive RGGI credit. This contention is not persuasive, however, because RGGI states have their own versions of energy efficiency standards and renewable portfolio standards, such that in-region generators are already subject to equivalent requirements.

electricity imported into RGGI from certain states that adopt GHG regulations producing measurable emissions reductions but not amounting to an equivalent cap-and-trade scheme. RGGI might consider including in any imports regulations adopted a procedure by which parties could petition to have certain out-of-region GHG compliance obligations granted equivalency status, or partial RGGI credit, as appropriate.¹²³

ii. Resource shuffling regulations do not negate a valid competitive advantage held by out-of-state generators.

Out-of-state generators may contend that requiring FJDs or LSEs to purchase allowances to cover emissions associated with imported electricity will effectively negate any competitive advantage they have from producing cheaper, dirtier electricity. This argument would follow the contours sketched out in *Hunt v. Washington State Apple Advertising Commission*.¹²⁴ In *Hunt*, the Supreme Court considered the constitutionality of a statute that prohibited all closed containers of apples sold or shipped in North Carolina from bearing any grade other than the applicable federal grade.¹²⁵ The statute was contested by Washington State, which had established its own stringent, mandatory inspection program in order to protect and enhance the reputation of Washington apples.¹²⁶ Washington's program employed a grading system that was consistently equivalent or superior to the comparable, national grades.¹²⁷

The Court invalidated the North Carolina statute for three reasons. The Court found that it “rais[ed] the costs of doing business in the North Carolina market for Washington apple growers and dealers” without a similar effect on their North Carolina counterparts, as

¹²³ See, e.g., 40 C.F.R. § 264.193 (allowing owners or operators of underground storage tanks to obtain variances from EPA's solid waste regulations if the owner or operator demonstrates that “alternative design and operating practices, together with location characteristics,” will create “equivalent protection” of ground and surface water).

¹²⁴ 432 U.S. 333 (1977).

¹²⁵ *Id.* at 335.

¹²⁶ *Id.* at 336.

¹²⁷ *Id.*

Washington entities were forced to alter their marketing practices.¹²⁸ The statute was also offensive to the dormant Commerce Clause because it “stripp[ed] away from the Washington apple industry the competitive and economic advantages *it ha[d] earned for itself through its expensive inspection and grading system.*”¹²⁹ Finally, the Court ruled that “because of the statute's operation, Washington apples which would otherwise qualify for and be sold under the superior Washington grades [would] now have to be marketed under their inferior USDA counterparts” and that “[s]uch ‘downgrading’ offer[ed] the North Carolina apple industry the very sort of protection against competing out-of-state products that the Commerce Clause was designed to prohibit.”¹³⁰

Challengers might try to suggest that, just as in *Hunt*, subjecting FJDs or LSEs to carbon regulations for the power they import will destroy the competitive advantage out-of-state generators enjoy in producing electricity that is not regulated for carbon. However, the conditions present in *Hunt* are not applicable in the context of resource shuffling regulations. Out-of-state generators do not have to alter their business practices in any way to continue participating in the regulated states’ electricity markets. In *Hunt*, Washington apple growers and dealers were forced to adjust their longstanding packaging practices in order to legally enter the North Carolina market at all.¹³¹ No such obligation would apply to out-of-state generators as a result of resource shuffling regulations; the full scope of compliance obligations would fall on FJDs or LSEs within RGGI states. Moreover, unlike the statute in *Hunt*, applying these resource shuffling regulations would not negate a quality-based advantage that another state specifically worked to develop. Instead, it would prevent important GHG regulations from being rendered

¹²⁸ *Id.* at 351.

¹²⁹ *Id.* (emphasis added).

¹³⁰ *Id.*

¹³¹ *See id.* at 347.

futile by emissions leaking to out-of-state generators that had taken no action to control GHG emissions, unlike their in-region counterparts. Responding to this argument again reflects the need to emphasize the interaction between resource shuffling regulations and direct regulations on in-state generators. Because of this interaction, we believe a court would be unlikely to find that resource shuffling regulations are a discriminatory measure.

One final point on the topic of discrimination: some have expressed concern over the impact that *Rocky Mountain Farmers Union v. Goldstene*, the California district court decision concerning that state's low carbon fuel standard (LCFS) mentioned earlier with respect to extraterritoriality, might have on a court's determination of whether imports regulations are discriminatory. The Eastern District of California found California's LCFS to be facially discriminatory on the ground that the standard's design treated Midwest corn-derived ethanol differently from similar corn-derived ethanol made in California, by assigning Midwest ethanol higher carbon intensity based on the location of the production facility and the distance the product traveled.¹³² This reasoning should not present cause for concern here. The district court in *Goldstene* was troubled by the fact that it read California's calculation methodology as favoring California ethanol producers over Midwest producers *in every instance*, by including distance as a discrete variable in the calculation formula.¹³³ In contrast, the resource shuffling regulations that we are considering do not exhibit such an in-state preference, instead assigning an emissions factor to all out-of-state sources simply as the best method of approximating the requirements already applied to all in-state generators (who will not necessarily fare better under the regulations than out-of-state generators). Origin does not in and of itself result in an automatically higher GHG value for out-of-state sources. Furthermore, it bears emphasizing that

¹³² No. CV-F-09-2234, 2011 WL 6934797, at *16 (E.D. Cal. Dec. 29, 2011).

¹³³ *Id.* at *9-10.

the *Goldstene* decision is merely a single district court opinion and is currently on appeal to the Ninth Circuit.¹³⁴ As such, it would serve as persuasive authority at best in any challenge that RGGI might face.

iii. Resource shuffling regulations *might* survive a strict scrutiny inquiry.

As discussed, we think it is unlikely that a court would conclude that regulations designed to stop resource shuffling are discriminatory. However, if a court decided that resource shuffling regulations were facially or effectively discriminatory, RGGI states would face the burden of demonstrating that the regulations were justified in terms of legitimate local benefits and the unavailability of nondiscriminatory alternatives.¹³⁵ In practice, a finding that a statute is discriminatory is typically fatal, hence its designation as grounds for “virtually *per se*” invalidation.¹³⁶ Nevertheless, RGGI states would have a reasonable argument that these import regulations would be a legitimate exception to that virtually automatic unconstitutionality. In *Maine v. Taylor*, 477 U.S. 131 (1986), the leading case in which a discriminatory statute was upheld, the Court allowed Maine’s ban on importing live baitfish to stand because parasites common to out-of-state baitfish could have a potentially severe effect on Maine’s ecology, and there was no way to effectively test live baitfish for the parasite.¹³⁷ The Court viewed the ban as motivated by reasons distinct from origin, making it acceptable despite its discriminatory nature.¹³⁸

¹³⁴ The Ninth Circuit most recently heard argument in this case on 16 October 2012.

¹³⁵ *Hunt*, 432 U.S. at 353.

¹³⁶ *See Or. Waste Sys., Inc. v. Dep’t of Env’tl. Quality of State of Or.*, 511 U.S. 93, 99 (1994).

¹³⁷ *Maine v. Taylor*, 477 U.S. 131, 138, 141, 151 (1986)

¹³⁸ *Id.* at 152.

While the exact nature of climate change is not fully understood, the Supreme Court has agreed that “[t]he harms associated with climate change are serious and well recognized.”¹³⁹ In *Taylor*, the Supreme Court made clear that states have “a legitimate interest in guarding against imperfectly understood environmental risks, despite the possibility that they may ultimately prove to be negligible.”¹⁴⁰ Thus, resource shuffling regulations would probably be viewed as addressing a legitimate state interest.

To demonstrate necessity, RGGI states should argue that resource shuffling regulations, including an assumed emissions factor, would be applied to FJDs and LSEs who import electricity not due to the origin of the electricity *per se*, but because of the difficulty in assessing the exact GHG emissions of out-of-state generators that are not directly subject to the enacting states’ regulations. Challengers would likely respond that RGGI states could simply enact more indirect measures to help limit leakage in a less discriminatory fashion, such as stronger in-state energy efficiency and renewable energy policies.¹⁴¹ There is a rebuttal against this argument in the case of imports regulations. In *Taylor*, the Supreme Court specifically said that in order to be constitutional, a discriminatory statute’s “purpose must be one that *cannot be served as well* by available nondiscriminatory means.”¹⁴² Even granting that indirect regulations may help mitigate RGGI states’ GHG footprint, RGGI should be able to demonstrate that they would be far less

¹³⁹ *Massachusetts v. EPA*, 549 U.S. 497, 521 (2007).

¹⁴⁰ *Taylor*, 477 U.S. at 148; *see also* *Massachusetts*, 549 U.S. at 521-22.

¹⁴¹ *See supra* note 20 for a discussion of potential indirect policies. A similar argument appeared persuasive in *Goldstene*, the recent California LCFS case discussed *supra*. No. CV-F-09-2234, 2011 WL 6934797, at *16 (E.D. Cal. Dec. 29, 2011). There, the court held that because California could increase vehicle efficiency, reduce the number of vehicle miles traveled, or adopt a fossil fuels tax instead of an LCFS, the state failed to establish that there were “no nondiscriminatory means by which California could serve its purpose of combating global warming through the reduction of GHG emissions.” *Id.* The court so held even though it recognized that these approaches “may be less desirable.” *Id.*

¹⁴² 477 U.S. at 140 (emphasis added).

effective in advancing that goal.¹⁴³ The overriding purpose of resource shuffling regulations would be to correct a crucial component of the regions' GHG cap-and-trade program by eliminating leakage, which might otherwise impair the RGGI program's effectiveness in addressing climate change's harmful impacts on the RGGI region.¹⁴⁴ Therefore, it is at least possible that RGGI states could satisfy the strict scrutiny test applied to discriminatory statutes. Nevertheless, considering the infrequency with which courts uphold discriminatory statutes, RGGI would be better served by avoiding a finding that resource shuffling regulations are discriminatory at all costs.

3. Resource shuffling regulations probably would survive *Pike* Balancing.

Because we believe that a reviewing court would not hold that resource shuffling regulations were discriminatory or extraterritorial, it would instead apply the *Pike* balancing test in order to decide whether the regulations were constitutional.¹⁴⁵ Resource shuffling regulations stand a good chance of surviving judicial scrutiny under the *Pike* balancing test. As described above, in order for a state law to survive the *Pike* review, it must 1) regulate even-handedly, 2) effectuate a legitimate local public interest, 3) affect interstate commerce only incidentally, and 4) impose a burden on interstate commerce that is not clearly excessive in relation to the putative local benefits.¹⁴⁶ “State laws frequently survive this *Pike* scrutiny.”¹⁴⁷

¹⁴³ In making this statement, it bears reiterating that we are assuming RGGI will not choose to adopt imports regulations unless it tightens its cap such that leakage becomes a major concern. Early draft analysis from a presentation at a March 2012 RGGI stakeholder session suggested that under a tightened cap, leakage would present a more serious problem. *See* Potential Scenarios for Modeling: Overview, Presentation to RGGI Stakeholder Session, March 20, 2012, at slide 30, *available at* http://www.rggi.org/docs/ProgramReview/March20/IPM-Modeling_030212.pdf.

¹⁴⁴ As RGGI has already documented, these harms include, among others, increased smog, sea level rise and the corresponding threat to coastal communities and infrastructure, saltwater contamination of drinking water, beach erosion, and an increase in habitats for disease-carrying insects. REG'L GREENHOUSE GAS INITIATIVE, MEMORANDUM OF UNDERSTANDING (2005).

¹⁴⁵ *See, e.g.,* Dept. of Revenue of Ky. v. Davis, 553 U.S. 328, 338-39 (2008).

¹⁴⁶ *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

¹⁴⁷ *Davis*, 553 U.S. at 339.

Once a court rules that a state law is non-discriminatory, it has functionally decided that the state law regulates even-handedly and affects interstate commerce only incidentally. The *Pike* balancing analysis is therefore really focused on two of the four factors enumerated above: whether the statute effectuates a legitimate interest and does not excessively burden interstate commerce.¹⁴⁸ We assume that if RGGI states were to adopt resource shuffling regulations, they would justify them on the ground that they are central to the program’s environmental integrity and its ability to effectively address the problem of climate change. Here, RGGI could point to its (predominantly coastal) participating states’ documented concerns over sea level rise and the corresponding threat to coastal communities and infrastructure, saltwater contamination of drinking water, beach erosion, and an increase in habitats for disease-carrying insects.¹⁴⁹ As noted *supra*, Supreme Court precedent has already confirmed that states have a legitimate interest in guarding against the environmental risks posed by climate change,¹⁵⁰ suggesting that the “legitimate interest” prong of *Pike* could easily be satisfied. The central question in a *Pike* analysis of resource shuffling regulations would likely thus be whether or not the burden imposed on interstate commerce by resource shuffling regulations would clearly exceed the putative local benefits derived from those regulations.¹⁵¹

There is a question as to how concrete the benefits sought by a State must be in order to survive a *Pike* inquiry. The First Circuit has emphasized that “it is the *putative* local benefits that matter. It matters not whether these benefits actually come into being at the end of the day.”¹⁵² Yet the Supreme Court has previously held that when a statute placed a “substantial burden on

¹⁴⁸ See *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 472 (1981)

¹⁴⁹ REG’L GREENHOUSE GAS INITIATIVE, MEMORANDUM OF UNDERSTANDING (2005).

¹⁵⁰ See *Massachusetts v. EPA*, 549 U.S. 497, 521 (2007); *Amer. Elec. Power Co. v. Connecticut*, 131 S. Ct. 2527, 2535 (2011); *cf. Taylor*, 477 U.S. at 148.

¹⁵¹ *Clover Leaf Creamery*, 449 U.S. at 472

¹⁵² *Pharm. Care Mgmt. Ass’n v. Rowe*, 429 F.3d 294, 313 (1st Cir. 2005).

interstate commerce and [could not] be said to make more than the most speculative contribution to [a sought benefit],” it violated the dormant Commerce Clause.¹⁵³ Taken together, these cases indicate that, the more certain benefits are, the more willing a court will be to overlook some burdens on interstate commerce.

We assume that RGGI will not choose to adopt imports regulations unless it also tightens its cap, such that leakage becomes a more prominent concern.¹⁵⁴ Therefore, although there is some debate over RGGI’s current efficacy in reducing GHGs given the precipitous drop in emissions that occurred after its initial cap was set, it should be the case that once RGGI might be in the position of defending imports regulations, it would be able to prove that the RGGI scheme would result in more than speculative GHG reductions. The states would be best served by framing the regulation broadly, focusing attention on the combined effects of resource shuffling regulations and the existing in-state source-based regulations. The benefits of resource shuffling regulations become more obvious and concrete when appropriately considered within the broad regulatory scheme. RGGI states should further elucidate this connection by documenting the potentially deleterious effects that leakage and resource shuffling could have on their goal of reducing their GHG footprint.

Opponents might also turn to the argument that the GHG reductions resulting from RGGI alone would not save participating states from the harms of climate change, such that RGGI does not produce a real benefit. RGGI states’ strongest response is that RGGI is part of their contribution to solving a global problem, adopted partly with the hope and expectation that it will spur action elsewhere. *Massachusetts v. EPA* supports the position that states have a strong—and indeed, special—interest in preventing the harms associated with climate change, even

¹⁵³ *Raymond Motor Transp., Inc. v. Rice*, 434 U.S. 429, 447 (1978).

¹⁵⁴ *See supra* note 143.

though the problem is a global one.¹⁵⁵ Moreover, to further emphasize the benefits of RGGI, RGGI states might point to the recent study that found that RGGI also confers substantial economic benefits on its participants.¹⁵⁶ Taken as a whole, then, we believe there is a good case to be made that the RGGI regime, including imports regulations, brings substantial state benefits.

These benefits must be weighed against out-of-state burdens. As discussed earlier, out-of-state generators that sell unspecified power into a power system with an emissions factor higher than the generators' actual emissions portfolios probably would have the strongest argument of a disproportionate burden. But again, just as this burden on a few generators should not lead to a finding of discrimination, it is also unlikely to amount to an impermissible burden on interstate commerce. In *Exxon*, the Supreme Court held that "interstate commerce is not subjected to an impermissible burden simply because an otherwise valid regulation causes some business to shift from one interstate supplier to another."¹⁵⁷ Here, even if application of a system-wide emissions factor causes FJDs or LSEs to obtain less electricity from certain out-of-state generators, it does not necessarily mean that business will shift to in-state generators. It is just as likely that the demand will be serviced by other out-of-state generation facilities, including new, clean, out-of-state generation facilities, which would be permitted to sell to FJDs or LSEs as specified sources not subject to the emissions factor assumptions.

If RGGI adopts a non-uniform emissions factor calculation method, there will be an even greater likelihood that only some out-of-state generators would be burdened, as opposed to the interstate market as a whole. In-state FJDs or LSEs would presumably shift their purchases to

¹⁵⁵ 549 U.S. 497, 522 (2007).

¹⁵⁶ THE ANALYSIS GROUP, THE ECONOMIC IMPACTS OF THE REGIONAL GREENHOUSE GAS INITIATIVE ON TEN NORTHEAST AND MID-ATLANTIC STATES (NOV. 2011), available at http://www.analysisgroup.com/uploadedFiles/Publishing/Articles/Economic_Impact_RGGI_Report.pdf.

¹⁵⁷ See *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127 (1978).

those generators that can offer the best combination of electricity price and low GHG emissions. Furthermore, taking the regulatory scheme as a whole, those in-state generators who are forced to spend heavily in order to comply with their own caps will need to pass the costs along to FJDs and LSEs. Combined, these burdens on FJDs/LSEs and in-state generators simply seek to accomplish the goal of reducing RGGI states' carbon footprint, and do not impermissibly burden interstate commerce in the process.

In sum, because hypothetical resource shuffling regulations would not deal with any transactions occurring entirely out-of-state, we believe a court would be unlikely to find them unconstitutional as an extraterritorial regulation. Likewise, a court would probably find that these regulations do not discriminate against out-of-state commerce, as they simply impose a cost on FJDs or LSEs who import electricity that is comparable to the cost already imposed on in-state generators subject to RGGI's cap-and-trade system. If this is correct, and a reviewing court ultimately applied the *Pike* balancing test to these regulations, we believe that, since the regulations would serve an important purpose and would not obviously result in a shift in demand from out-of-state electricity to in-state electricity, there is a good chance that the court would uphold the regulations as a constitutionally valid exercise of state power.

IV. THE FEDERAL POWER ACT

Opponents to imports regulations might also argue that such measures are preempted by the FPA, which grants the federal government exclusive jurisdiction in some areas of electricity regulation. We believe that this is a relatively weaker argument than a dormant Commerce Clause claim and would not be likely to succeed, for reasons explained below.

a. Overview of Preemption and the FPA

The doctrine of preemption is derived from the Supremacy Clause of the U.S. Constitution,¹⁵⁸ which makes federal law the supreme law of the land and thus implies that state laws that contradict federal law cannot stand.¹⁵⁹ Congressional intent “is the ultimate touchstone in every pre-emption case.”¹⁶⁰ However, findings of preemption are not favored; the presumption against preemption dictates that in all preemption cases, courts “start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.”¹⁶¹ These are the two “cornerstones” that go into any preemption analysis.

Preemption can be either express or implied. Express preemption arises when Congress makes explicit in a statute its intent for Federal legislation to have preemptive effect.¹⁶² Implied preemption results when “compliance with both federal and state regulations is a physical impossibility,”¹⁶³ when state law impedes the federal law’s objective,¹⁶⁴ or when “[t]he scheme of federal regulation . . . [is] so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it.”¹⁶⁵

The FPA’s primary purpose is “to regulate the rates and charges of . . . interstate energy”¹⁶⁶ for “the protection of the public interest generally, [and] likewise the interest of the

¹⁵⁸ U.S. CONST. art. VI, cl. 2.

¹⁵⁹ *See, e.g.,* *Gonzales v. Raich*, 545 U.S. 1, 29 (2005) (“The Supremacy Clause unambiguously provides that if there is any conflict between federal and state law, federal law shall prevail.”).

¹⁶⁰ *Wyeth v. Levine*, 555 U.S. 555, 565 (2009) (quoting *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996)).

¹⁶¹ *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S.Ct. 1146 (1947)).

¹⁶² *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977).

¹⁶³ *Hillsborough Cnty., Fla. v. Automated Med. Labs., Inc.*, 471 U.S. 707, 713 (1985) (quoting *Fla. Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43, 83 S.Ct. 1210 (1963)).

¹⁶⁴ *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404 (1941).

¹⁶⁵ *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947) (citing *Pa. R. Co. v. Pub. Serv. Comm’n*, 250 U.S. 566, 569, 40 S.Ct. 36, 37 (1919)).

¹⁶⁶ *Conn. Light & Power Co. v. FPC*, 324 US 515, 524 (1945).

consumer and the investor.”¹⁶⁷ The FPA grants the Federal Energy Regulatory Commission (FERC) jurisdiction over “the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce.”¹⁶⁸ It also tasks FERC with setting “just and reasonable” rates for wholesale power.¹⁶⁹ The Supreme Court has interpreted these grants of authority to give FERC “exclusive jurisdiction over the rates to be charged . . . interstate wholesale customers.”¹⁷⁰ However, the FPA also specifies that FERC’s jurisdiction “extend[s] only to those matters which are not subject to regulation by the States.”¹⁷¹

b. FPA Preemption of Imports Regulations

We believe that imports regulations would likely withstand an FPA preemption challenge. First, the FPA contains no statement of express preemption.¹⁷² Consequently, if the FPA were to preempt state imports policies, it would have to be through implied preemption. But we do not believe there is a strong argument to be made that imports regulations interfere with FERC’s jurisdiction over interstate transmission or the wholesale electricity market in such a way that implied preemption could attach.

The strongest argument that could be made in favor of implied preemption by opponents of imports regulations would likely be along the following lines: imports regulations would directly affect wholesale electricity rates by adding to the cost of any out-of-state power imported into the RGGI region an additional cost for allowances to cover associated GHG emissions. In this way, opponents might claim that imports regulations would infringe upon FERC’s exclusive jurisdiction over wholesale rates.

¹⁶⁷ *Louisville Gas & Elec. Co. v. FPC*, 129 F.2d 126, 133 (6th Cir. 1942).

¹⁶⁸ 16 U.S.C. § 824(a) (2006).

¹⁶⁹ *Id.* § 824(a).

¹⁷⁰ *See Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986).

¹⁷¹ 16 U.S.C. § 824d(a).

¹⁷² *See Federal Power Act*, 16 U.S.C. §§ 791-823 (2006)

This is not a particularly convincing argument.¹⁷³ Although the FPA declares that the federal government is expressly imbued with the power to regulate “the sale of . . . energy at wholesale in interstate commerce,”¹⁷⁴ it limits the extent of this “only to those matters *which are not subject to regulation by the States.*”¹⁷⁵ This is a clear textual indication that the drafters of the FPA did not intend for the statute to preempt all state activity in the field of electricity supply and demand, even when state regulation might *incidentally* affect wholesale prices.¹⁷⁶

Of potential relevance to the determination of whether imports regulations might impermissibly infringe on wholesale rate setting are recent controversies over the permissibility of state feed-in tariffs. A feed-in tariff is a policy instrument that guarantees developers of renewable generation a certain price, or a fixed premium above the spot market price.¹⁷⁷ This fixed-price guarantee increases the price certainty for renewables—a strategy that has proven very successful in incentivizing new renewable generation in European countries that have adopted it.¹⁷⁸ As U.S. states have begun adopting feed-in tariffs, challengers have questioned their viability under the FPA, as they essentially mandate a certain wholesale price be paid for renewable electricity purchases.¹⁷⁹ In response to a challenge to a California feed-in tariff for

¹⁷³ However, in *North Dakota v. Lori Swanson*, No. 11-3232 (D. Minn. Sept. 30, 2012) (order granting in part and denying in part motion for judgment on the pleadings), out-of-state electricity producers pled sufficient facts to support a claim that a Minnesota import law was preempted by the FPA. “Since Congress delegated exclusive jurisdiction to FERC to regulate the transmission and sale of electric energy at wholesale in interstate commerce,” fact finding would be necessary to determine whether specific provisions of the Minnesota law conflicted with the FPA.

¹⁷⁴ 16 U.S.C. § 824(a).

¹⁷⁵ *Id.* (emphasis added).

¹⁷⁶ See *Hillsborough Cty., Fla. v. Automated Med. Labs., Inc.*, 471 U.S. 707, 715 (1985).

¹⁷⁷ See Steven Ferrey et al., *Fire and Ice: World Renewable Energy and Carbon Control Mechanisms Confront Constitutional Barriers*, 20 DUKE ENVTL. L. & POL’Y F. 125, 169-70 (2010).

¹⁷⁸ See *id.* at 170-71. In fact, in some European countries the debate is now over whether feed-in tariffs have been too successful in promoting renewables development, and therefore too expensive for consumers. See *id.* at 172.

¹⁷⁹ Feed-in tariffs also face challenges under the Public Utility Regulatory Policies Act (PURPA), which “does not permit either the FERC or the states to require a purchase rate that exceeds the utilities’ avoided cost.” *Id.* at 197. But imports regulations would be unlikely to face a PURPA challenge, as they would not mandate a purchase rate in the same way that a feed-in tariff does.

combined heat and power, FERC issued an opinion that at least places limits on the way that feed-in tariffs can be designed.¹⁸⁰

Unlike feed-in tariffs, however, imports regulations would not mandate a particular purchase price for certain types of wholesale electricity. Instead, imports regulations would place a separate obligation on LSEs or FJDs to purchase emissions allowances to cover emissions associated with their electricity purchases. By imposing these compliance obligations, the regulations would create an added cost for retail customers and new incentives for LSEs and FJDs to try to keep costs low. The regulations might therefore affect the business incentives and portfolio choices that LSEs or FJDs make in their wholesale purchasing decisions, but this is a far cry from directly mandating wholesale purchase rates.¹⁸¹ This distinction is an important one that should save imports regulations from the same potential FPA vulnerability faced by feed-in tariffs. Imports regulations are more easily analogized to renewable portfolio standards (RPS), which require utilities to purchase certain percentages of renewables and thereby *indirectly* impact wholesale market choices, but do not directly dictate wholesale market prices. And FERC has indicated that it believes RPS-type state policies to be permissible.¹⁸²

Further support for imports regulations' permissibility can be found outside the FPA context in the Supreme Court's consideration of analogous statutes. In particular, several

¹⁸⁰ Cal. Pub. Utils. Comm'n, 133 FERC ¶ 61,059 (2010).

¹⁸¹ It is worth noting that an FJD scheme may be slightly more constitutionally suspect than a load-based scheme in terms of FPA preemption. Some FJDs are wholesale power marketers, and are therefore within the exclusive jurisdiction of FERC for the sales that they make across state lines. However, we are not convinced that this distinction would make a significant difference, as any compliance obligations placed on an FJD would still not dictate the wholesale price paid by that FJD for out-of-state power purchases. Instead, regulations would simply seek to ensure that FJDs operating within a state or region helped the state/region to achieve its environmental objectives by purchasing allowances to cover imported emissions. Nevertheless, given states' expansive traditional authority over LSEs, it might be legally safer to choose to place the compliance obligations on these entities rather than FJDs.

¹⁸² See S. Cal. Ed. Co., 71 F.E.R.C. ¶ 61,269 (1995) ("The Commission believes that states have numerous ways to . . . encourage renewable resources. . . . [Assuming] state law permits, [they] may order utilities to purchase renewable generation.").

commentators have pointed to the Supreme Court’s consideration of the Atomic Energy Act in *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission* (“*PG&E*”).¹⁸³ Similar to the FPA, the Atomic Energy Act splits authority between the states and the federal government: whereas the “federal government maintains complete control of the safety and ‘nuclear’ aspects of energy generation,” states maintain “their traditional authority over the need for additional generating capacity, the type of generating facilities to be licensed, land use, ratemaking, and the like.”¹⁸⁴ Petitioners in *PG&E* asserted that a California regulation requiring nuclear developers to demonstrate adequate capacity for a proposed plant’s spent fuel rods in order to gain state approval for the plant was preempted by the Atomic Energy Act. The Court disagreed, holding that because the Atomic Energy Act occupied only the field of nuclear safety, state regulations not passed for the *purpose* of regulating nuclear safety were permissible. Because California justified its spent fuel rods regulation on economic grounds, rather than nuclear safety grounds, the court found it not to be preempted, even though it clearly impacted whether and when nuclear plants could be built.¹⁸⁵

PG&E supports the conclusion that state import regulations enacted for the purpose of controlling leakage should be similarly permissible. As discussed above, although such regulations might indirectly impact wholesale power rates, they are not aimed at ratemaking as an end goal. Instead, import regulations would serve the purpose of ensuring the environmental integrity of the RGGI program, thereby preserving participating states’ environments and contributing to the health and safety of their citizens. Such goals are well within traditional state police powers and therefore should fall outside of FERC’s exclusive jurisdiction over wholesale

¹⁸³ 461 U.S. 190 (1983).

¹⁸⁴ *Id.* at 212.

¹⁸⁵ *Id.* at 216.

power rates.¹⁸⁶ Language from *Northwest Central Pipeline Corp. v. Kansas*, a case considering federal preemption under the Natural Gas Act (an act that reserves *less* power for the states than the FPA), further supports this conclusion.¹⁸⁷ There, the Court stated that “[w]here state law impacts on matters within FERC’s control, the State’s purpose must be to regulate production or other subjects of state jurisdiction, and the means chosen must at least plausibly be related to matters of legitimate state concern.”¹⁸⁸ This test would likely be met for import regulations, as long as an emissions leakage problem could be demonstrated.

In sum, we do not think imports regulations are likely to be held to be preempted by the FPA. The FPA expressly left room for state regulation within the electricity field on matters other than wholesale ratesetting and interstate transmission, and imports regulations would be a valid use of traditional state authority to regulate health and environmental impacts.

V. SPECIAL ISSUES RELATING TO CANADIAN IMPORTS

In addition to importing power from neighboring U.S. states that are not participating in RGGI, RGGI states also import power from three Canadian provinces: Quebec, Ontario, and New Brunswick. There are two additional legal issues worth flagging with respect to regulation of imports from Canada. First, RGGI should be aware that a dormant Commerce Clause analysis may differ slightly with respect to electricity imported from Canada. Case law on this point is sparse, particularly outside of the taxation context. The Supreme Court has indicated, however, that when considering the validity of a regulation under the dormant foreign Commerce Clause, courts should also consider the potential for international multiple taxation and whether a state

¹⁸⁶ As NRDC pointed out in briefing to the California Energy Commission, FERC itself recognized that environmental regulation is a traditional state role in the preamble to its Order No. 888. See Legal Brief of the Natural Resources Defense Council and Environmental Defense on the “First Seller” Approach, Cal. Energy Comm’n Docket No. 07-OIIP-01 (August 6, 2007), available at http://docs.cpuc.ca.gov/published/proceedings/R0604009_doc.htm.

¹⁸⁷ 489 U.S. 493 (1989).

¹⁸⁸ *Id.* at 518.

policy would prevent the Federal Government from speaking with “one voice when regulating commercial relations with foreign governments.”¹⁸⁹

On the topic of double taxation, it is important to note that Quebec will be implementing its own cap-and-trade system in 2013.¹⁹⁰ It is not clear whether imports regulations would amount to a “tax” per se, such that they would implicate any of the double-taxation issues that often arise in the foreign dormant Commerce Clause context.¹⁹¹ Nevertheless, RGGI should consider how it wants to treat electricity imported from Quebec. To subject Quebecois imports to the same compliance obligations as imports not subject to any carbon cap would arguably double-count emissions associated with their electricity production. This would unfairly disadvantage Quebecois generators, particularly given the relative stringency of Quebec’s cap vis-à-vis the cap currently imposed by RGGI states on in-state generators. There might be several ways to go about ensuring that imports from Quebec receive fair treatment in RGGI, the technical details of which are beyond the scope of this analysis. For present purposes, the bottom line is that RGGI should work to find a way to treat imports from Quebec appropriately in order to avoid any foreign dormant Commerce Clause concerns.

Second, there is a potential North American Free Trade Agreement (NAFTA) issue that could arise with respect to how Canadian versus U.S. government-owned hydropower is treated.

¹⁸⁹ *Japan Line, Ltd. v. Los Angeles*, 441 U.S. 434, 451 (1979).

¹⁹⁰ Quebec’s program takes effect in 2013 and runs through 2020. *Summary of Quebec’s Cap-and-Trade System*, INT’L EMISSIONS TRADING ASS’N, 4 (Feb. 23, 2012),

http://www.ieta.org/assets/ieta_quebec%20cap%20and%20trade%20summary.pdf. It will initially cover the industrial and electricity sectors before expanding to include fuel distributors and importers as well as transport emissions. *Id.* at 5. The program’s goal is to reduce GHG emissions to 20% below 1990 levels by 2020. *Id.* at 1.

¹⁹¹ Even if a court *did* characterize these regulations as a tax, the Supreme Court has explained that the foreign commerce clause does not require a complete forbearance of taxation whenever a foreign sovereign may also tax the same activity. *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 193 (1983). The Supreme Court has also looked favorably upon state schemes which provide a tax credit when a corporation has properly paid a tax in another jurisdiction on the same activity. *Itel Containers Int’l Corp. v. Huddleston*, 507 U.S. 60, 75 (1993). Policy implications aside, RGGI may thus want to consider providing an exception to FJDs’ or LSEs’ compliance obligations when importing electricity from Quebec in order to further avoid constitutional hurdles.

In California's scheme, one of the exceptions to its prohibition against "specified" contracts is deliveries from federally-owned hydropower facilities, from their exclusive marketers, or otherwise allocated by contract with the federal government.¹⁹² British Columbia Hydro has objected to this exception being extended only to U.S.-owned hydropower, arguing that Canadian government-owned hydropower deserves the same exceptions.¹⁹³ Otherwise, it has argued, California's regulations risk running afoul of NAFTA.¹⁹⁴ Given its different and in some ways more sophisticated technical capabilities to track imports, RGGI may be able to avoid the need faced in California to grant federal hydropower a resource shuffling exemption, and thus might not face this same legal challenge. But RGGI states should be aware of this issue if they move forward in designing imports regulations.

CONCLUSION

Based on our analysis of the dormant Commerce Clause and the FPA, we believe that the imports regulations are likely to ultimately be ruled constitutional by a reviewing court. In order to better assure this finding, we believe that RGGI would be best served by applying a tailored emissions factor that reflects the approximate emission levels of various geographic regions that produce electricity. By doing this, RGGI would have a stronger argument that the emissions factor method is intended to, and does, reflect the relative cleanliness of electricity generation and is not merely a penalty imposed on FJDs or LSEs who procure electricity from out-of-state.

¹⁹² See Presentation by Scott Murtishaw, RGGI Learning Session (Oct. 11, 2011), available at http://www.rggi.org/docs/ProgramReview/LearningSession1/Presentation_Scott_Murtishaw_CA_PUC.pdf.

¹⁹³ See Gordon Hamilton, *BC Hydro Plays NAFTA Card in Bid to Win Green Status in California; Energy-Trading Arm Claims Clean-Energy Exemption for U.S. Power Supplier is Discriminatory*, VANCOUVER SUN, Oct. 21, 2011, at C1, available at 2011 WLNR 21614973.

¹⁹⁴ However, at least as explained in one article, one of the reasons that BC Hydro was not accorded similar status is that it imports U.S. coal-fired electricity during some periods, complicating its status as a true hydropower source. *Id.*

By avoiding the appearance of legislating or regulating in a discriminatory, protectionist fashion, RGGI states are more likely able to combat emissions leakage in a legally permissible way.