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Constitutional Issues to Consider in Clean Power Plan Compliance

Part 2: The Dormant Commerce Clause

Kate Konschnik
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I. Introduction

Our previous paper concluded states can file joint or linked plans to facilitate Clean Power Plan (CPP) compliance for affected power plants, without violating the Constitution's Compact Clause. That clause prohibits expansion of state power at the federal government's expense.

The Constitution's Commerce Clause places additional restraints on state power. It authorizes Congress to "regulate commerce . . . among the several states." Courts interpret the provision to limit a state's power over interstate commerce. This doctrine, known as the dormant Commerce Clause (DCC), restricts state discrimination against out-of-state goods; prohibits states from wholly regulating out-of-state activity; and limits their ability to burden interstate commerce.

States may argue that because approved state plans are federally enforceable, they are federal law and immune to DCC scrutiny. This is an open question. States may also argue that Congress authorized state action that discriminates against or burdens interstate commerce, by establishing a state-based planning scheme under Section 111. But congressional intent "must be either 'unmistakably clear' or 'expressly stated.'"[1] Once states allow trading of allowances or ERCs for compliance, the Clean Air Act does not clearly inoculate a plan that discriminates between compliance instruments based on origin or places barriers on their interstate trade. Therefore, consideration of DCC issues is prudent.

This paper describes how states can navigate the DCC while achieving their CPP policy goals.

TAKE-AWAYS

- With careful planning, states can navigate the DCC and achieve CPP policy goals.
- States can negotiate joint or linked plans with other states without violating the DCC. They may not be able to isolate other states for not adopting reciprocal plan elements.
- States may be able to prevent automatic linking to states with different plan elements, if they accept allowances for compliance based on plan attributes rather than origin, and if they can articulate non-protectionist benefits for the attributes.
- States should be able to create their own single-state compliance plan.
- States can write rules to prevent leakage and resource shuffling, if those rules apply to in-state actors and place limits on imports that are equivalent to in-state requirements.
- Trading-ready states can limit ERC eligibility based on type of generator but not origin.
- The DCC does not likely constrain the state's initial allowance allocation.

II. Market-Based Approaches to the Clean Power Plan

The CPP establishes performance rates for coal and natural gas electric generating units (EGUs). EPA also calculated equivalent average emission rates for each state and state-wide mass carbon budgets. A state chooses which targets to apply.

- Under a rate-based plan, each EGU must meet a specified emission rate (in pounds of CO_2 per megawatt hour). EGUs may purchase emission rate credits (ERCs) generated by lower-emitting resources to administratively adjust their rates.
- Under a mass-based plan, EGUs must hold one allowance for each ton of CO_2 emitted. If trading is allowed, allowances may be bought and sold between sources.

The CPP encourages trading, to "commoditize compliance … [which] reduces the overall costs of controls and spreads those costs among the entire category of regulated entities while providing a greater range of options for sources…."[2] Making pollution compliance a commodity creates markets.

Moreover, trading between private firms places this commodity in interstate commerce. The CPP preamble promotes large trading markets, noting "there is no reason that whatever geographic limits may exist for electricity and capacity transactions by an affected EGU should also limit the EGU's transactions for validly issued rate-based emission credits or mass-based emission allowances."[3] State plans that discriminate or erect barriers to the free flow of compliance instruments, then, could trigger DCC concerns.

Yet the preamble never mentions the DCC, and EPA's Legal Memorandum dispenses with the issue quickly.[4] EPA may be right to suggest that the risk of a DCC challenge to EPA's plan approval or to plan implementation is low. However, states may want to think through the issues to manage and mitigate whatever risk exists. This paper discusses four areas creating possible risk: identifying trading partners (or inhibiting inter-state activity); preventing emissions "leakage" to other states; restricting ERC eligibility to in-state producers; and structuring initial allowance allocations.

The paper proceeds with a primer on the DCC. Then, it discusses whether the DCC applies to state plans and compliance instruments. Finally, the paper explores the four areas of plan design.

III. Dormant Commerce Clause

Article I, § 8, cl. 3 of the Constitution states that "Congress shall have power … to regulate commerce with foreign nations, and among the several states, and with the Indian tribes."

In 1824, Supreme Court Chief Justice Marshall suggested that this clause conferred *exclusive* authority to Congress to regulate trade "between the states".[5] Therefore, states could not regulate or burden interstate commerce even when Congress did not act (was "dormant").

While some Justices have opposed this interpretation of the Commerce Clause – from Chief Justice Taney in the early 1800's to Justice Thomas today – the rule stands that a state generally may not:

(1) discriminate against out-of-state economic interests;
(2) regulate commerce occurring wholly outside the state ("extra-territorial" regulation); or
(3) impose burdens on interstate commerce clearly excessive relative to local benefits.[6]

Discriminatory (1) and extraterritorial (2) laws are often per se invalid (some exceptions for discrimination are discussed below). Otherwise, a court will balance a law's local benefits against its burden on interstate commerce (3), usually deferring to the state at this stage. We describe each hurdle, providing examples.

Discriminatory state laws

"In all but the narrowest circumstances," courts will void a state law that explicitly benefits in-state economic interests at the expense of out-of-state competitors.[7] For instance, the Supreme Court invalidated a law requiring Oklahoma utilities to purchase coal from in-state suppliers,[8] and a utility commission order barring the export of New Hampshire hydropower.[9] In recent years, in-state requirements for Renewable Portfolio Standard (RPS) eligibility have been challenged on these grounds.[10] States have changed their RPS laws in reaction, often mooting the challenges but suggesting states see the vulnerabilities of such laws.[11]

Courts will also strike down laws discriminatory in purpose or effect. Challengers must bring "substantial evidence of an actual discriminatory effect" to prevail.[12] The Seventh Circuit voided two laws encouraging utilities to install scrubbers to comply with the federal Clean Air Act,[13] when it was clear the intent of legislation was to favor use of local high-sulfur coal over lower-sulfur coal from other regions.[14]

For a discriminatory law to survive a DCC challenge, a state must show that the law (1) serves a legitimate purpose (2) which cannot be served as well by available nondiscriminatory means.[15] Under this test, the Supreme Court has upheld quarantine laws to prevent import of pests[16] and groundwater export limits.[17] A lower federal court found a plan to induce new in-state power generation did not discriminate because the state was attempting to relieve transmission congestion and improve reliability.[18] States justify energy deliverability requirements on reliability and local air quality grounds;[19] whether those justifications will withstand DCC scrutiny is still unclear.

Courts will also uphold seemingly discriminatory laws that fall *outside* the scope of the DCC:

(1) States may discriminate between entities that do not compete.[20] For instance, Phoenix, AZ prohibited pet stores from selling professionally bred dogs. The district court rejected arguments that it discriminated against out-of-state breeders in favor of local animal shelters, because the entities serve different purposes.[21] In the energy context, the Supreme Court upheld an Ohio tax exemption for natural gas distribution companies, concluding these local companies did not compete with the interstate wholesalers challenging the exemption.[22] Similarly, the California PUC approved RPS rules requiring resources to be connected to a California balancing authority, finding that connected generators offer a different product – the clean energy associated with the REC – and so do not compete with more remote generators.[23]

(2) When a public entity provides a "core function" such as waste disposal,[24] a state or local government may set rules favoring its services over out-of-state companies.[25]

(3) If a state acts as a "purchaser, seller, or producer,"[26] under the "market participant" theory it can prefer local firms to out-of-state competitors. The Supreme Court has upheld a South Dakota policy to prioritize sales from a state-owned cement plant to in-state buyers,[27] and a local hiring requirement for city-financed construction in Boston.[28]

As we discuss in Part IV, states should avoid appearing to discriminate against out-of-state firms or interstate commerce when they name trading partners or exclude EGUs in certain states from their allowance or ERC markets. Similarly, states might consider the discrimination prong of the DCC before, for instance, requiring EGUs to purchase in-state ERCs for compliance with a rate-based plan.

Extraterritorial state laws

In contrast to economic discrimination, a law "that directly controls commerce occurring wholly outside the boundaries of a state" is never justified.[29] The extra-territoriality inquiry turns on whether the law wholly controls conduct in another state:[30] "no state may force an out-of-state merchant to seek regulatory approval in one state before undertaking a transaction in another."[31]

Courts apply extra-territoriality as a stand-alone rule, or use it as evidence of an unlawful burden on interstate commerce (described in the next section).[32] The Supreme Court does not often invoke extraterritoriality in either context,[33] and rumblings on lower courts suggest the doctrine should be abandoned entirely or limited to price control laws.[34]

But the Court has not explicitly limited this line of reasoning to pricing laws;[35] it has applied the principle to void statutes that condition action on reciprocity from other states,[36] an Illinois securities law regulating takeover offers by firms with limited contacts in the state,[37] and waste flow rules that "attach restrictions … to control commerce in other states."[38] Other federal courts also "have extended the rule … to cases where the 'price' floor being imposed on another jurisdiction was not monetary, but rather a minimum standard of environmental protection."[39]

Finally, extra-territoriality is invoked in arguments that multiple state laws create inconsistent obligations, making it impossible for a company engaged in the interstate market to comply in all jurisdictions.[40]

The extra-territoriality claim has been raised in several recent energy lawsuits. Petroleum trade groups and out of-state ethanol producers challenged California's Low Carbon Fuel Standard (LCFS), claiming among other things that the regulations controlled ethanol production occurring wholly outside of the state. California caps the average carbon intensity of fuels produced in and imported to the state, and scores intensity using factors such as the source of electricity used to power the refinery and the distance the product is transported. In 2013, the Ninth Circuit held the LCFS was not extra-territorial because it applies carbon standards only to in-state purchasers of fuels.[41] The court distinguished between "statutes 'that regulate out-of-state parties directly' – which are unconstitutional – from those that 'regulat[e] contractual relationships in which at least one party is located in [the regulating state]'."[42]

On the other hand, a federal court found a law prohibiting "any person" from importing coal-powered electricity into Minnesota was extra-territorial, because Minnesota could use the broad language to halt electricity sales on the regional grid between entities in two other states.[43] The decision analogized to other voided laws, including a Michigan labeling law requiring a unique mark on bottles sold in state (and banning the sale of the bottles elsewhere).[44] In June 2016, the Eighth Circuit affirmed. The three judges wrote separate opinions; only one invoked the DCC.[45]

As we discuss in Part IV, states should consider extra-territorial effects as they evaluate responses to potential emissions "leakage." EPA requires plans to address leakage *within* a state between plants under a mass cap and new uncapped NGCC plants. But the CPP does not require limits on *interstate* leakage from EGUs covered by a cap to EGUs subject under rate-based standards. Mass-based states concerned about interstate leakage should be careful to avoid extra-territorial regulation of their rate-based neighbors. In addition, states should avoid appearing to isolate states that set different market rules.

State laws that place an undue burden on interstate commerce

A law that does not discriminate impermissibly or regulate extraterritorially, and is "directed to legitimate local concerns,"[46] may prevail unless "the burden imposed on commerce is clearly excessive in relation to the putative local benefits."[47] The Court established this test when it voided a law requiring in-state processing of Arizona cantaloupes. There, the Court found that the burden of companies needing to build new processing facilities outweighed the benefit to Arizona (enhancing the reputation of its melons).

Despite this particular holding, state laws "frequently survive" the so-called *Pike* balancing test,[48] so long as the state creates a record establishing the net benefit of the law.[49]

Applying the *Pike* analysis, the Supreme Court upheld an Arkansas Public Service Commission order regulating the wholesale rates of an electric cooperative.[50] Although the order could affect interstate prices, that potential burden did not outweigh the state's interest in protecting cooperative ratepayers.[51] Similarly, the Second Circuit upheld a New York town's ordinance banning high-speed ferry traffic into its port, because the public health and safety benefits outweighed the burden on a Connecticut ferry company to select another port.[52]

IV. CPP Compliance Decisions and the Dormant Commerce Clause

This section discusses four areas where states should consider the DCC in designing their CPP plans: identifying trading partners; addressing leakage concerns; restricting ERC eligibility; and, allocating allowances. The section places different state decisions along a continuum of risk, and offers suggestions to states for limiting DCC risk when designing their CPP compliance plan. It concludes that with careful planning, states can navigate the DCC and achieve their policy goals.

Threshold matter: Does the DCC apply to the CPP?

States might make at least three arguments that the DCC does not apply to state plans submitted and approved under Section 111(d) of the Clean Air Act. None of these questions is settled.

First, approved CPP plans may be immune from the DCC because the approved "requirements have the force and effect of federal law."[53] Under the Clean Air Act, once EPA approves a state plan, EPA may enforce its provisions directly against power plants.[54] One could argue the approval process therefore converts a state plan literally into federal law and so inoculates its contents from DCC scrutiny. No case on point exists. But in reviewing federally approved state programs that do not become federally enforceable, courts have rejected arguments that Congress sanctions state discrimination by establishing an approval process.[55] And one court found another Clean Air Act provision only enjoys "federal law" status for purposes of this statute.[56]

Second, Congress might have authorized states to "restrict the flow of interstate commerce" in Clean Air Act plans. Congress can override the DCC prohibitions[57] if it makes its intent "'unmistakably clear' or 'expressly stated.'"[58] Congress established a state-based framework for several Clean Air Act programs, including Section 111, the authority for the CPP. Section 111 empowers states to implement and enforce standards for existing sources within state borders;[59] therefore, some plan aspects are necessarily limited to in-state entities, which, a state could argue, is evidence of Congress's "unmistakably clear" intent to inoculate state Clean Air Act plans from DCC scrutiny.

But as compliance instruments move further from the regulator and become commodities in interstate commerce, state restrictions on their trade between private entities across state borders may look more like limits on interstate market activity than clean air regulation. The more a plan element appears like economic protectionism, the greater the risk that Congress did not sanction this in the Clean Air Act.

Third, allowances and ERCs may not be "commerce" because they are state creations, designed for compliance with a regulatory program. The Court has interpreted the word "commerce" broadly:

> Whatever other meanings 'commerce' may have included in 1787, the dictionaries, encyclopedias, and other books of the period show that it included trade: businesses in which persons bought and sold, bargained and contracted.[60]

What may be traded is likewise broad. "[T]ransactions be commerce though non-commercial; they may be commerce though illegal and sporadic, and though they do not utilize common carriers or concern the flow of anything more tangible than electrons and information."[61]

A state's initial sale or giveaway of allowances for the right to pollute may not be "commerce." But once a state allows trading – with firms across state lines and perhaps even if limited to in-state – the allowances enter the stream of commerce to be bought and sold by private entities. ERCs may become commerce even sooner, since they are not regulatory permits but credits generated through the activities of private entities. As one scholar put it, the question becomes "whether and how a state can maintain regulatory authority over environmental quality within its own borders once it chooses to embody that authority in objects of commerce that may then be subject to broader market forces."[62]

In summary, states could argue that EPA approval of the plans makes them federal law, and so the DCC is not applicable. (A DCC challenge might still be made to EPA's approval of that plan.) They might argue that Congress sanctioned state discrimination by creating state-specific compliance programs under the Clean Air Act. Or, they could argue that regulatory compliance instruments are not commerce. But given the open questions as to DCC applicability, states pursuing a low-risk strategy should consider DCC limits.

Identifying (or rejecting) trading partners

For CPP compliance, states can submit joint plans requiring EGUs to meet a total mass cap or a weighted average of each state's emission rate,[63] or stand-alone plans that name trading partners. Partners might include states that negotiate common plan elements with one another, share common utilities, or sit in the same RTO footprint.

The CPP also enables "trading ready" plans to link automatically. In EPA's proposed CPP model rules, mass-based plans or rate-based plans can link so long as each (1) accepts allowances originating in other states for compliance purposes, (2) uses identical compliance instruments, and (3) relies on an EPA-run tracking system.[64] The only other condition for linking is the nature of the compliance regime – linked plans must implement a mass-based cap, or rate-based standards applicable to all EGUs.[65]

Because EPA proposes to require uniformity for so few plan elements, states can make different design choices and still enable EGUs to participate in interstate markets. For instance, a mass-based state could set a price floor or reserve a percentage of allowances as a cost containment reserve; auction or freely allocate allowances; or include new sources under the cap. Such features would not bar a state from linking with states making different policy choices. EPA's minimal linkage requirements help to create the broadest possible trading markets, a goal widely supported by economists to facilitate efficient compliance. The DCC reinforces this idea by generally preventing states from erecting barriers to trade.

However, the Supreme Court has

> recognized that mutually beneficial objectives may be promoted by voluntary reciprocity agreements, and that the existence of such an agreement between two or more States is not a per se violation of the Commerce Clause of which citizens of non-reciprocating States who do not receive the benefits conferred by the agreement may complain.[66]

Therefore, groups of states could negotiate specific agreement among themselves, to craft plans with additional common elements; for instance, to include new sources under the cap or limit types of ERC generators. States in these agreements could still accept allowances from every state that meets EPA's minimum linking requirements. In this way, a bloc of states could lead by example in an open market.

States might want to go a step further, and limit the allowances or ERCs their EGUs could use for compliance, based on the state of origin. For instance, participating states could refuse to accept allowances or ERCs for compliance generated in any state but those identified. Or, states could condition linkage on reciprocal treatment by other states (acceptance of allowances or adoption of similar plan designs). These limits could raise DCC concerns. In a financial services case, the Court wrote

> [t]here can be little dispute that the [DCC] would prohibit a group of States from establishing a system of regional banking by *excluding bank holding companies from outside the region* if Congress had remained completely silent on the subject.[67]

Moreover, "it is clear that no single State could [enact a policy for the entire Nation] or even impose its own policy choice on neighboring States."[68] A valid local health goal "may not be accomplished by discrimination against articles of commerce coming from outside the state unless there is some reason, apart from their origin, to treat them differently."[69]

Therefore, states limiting the allowances they will accept (or discounting allowances) based on origin could face DCC risk. Moreover, states should avoid "us[ing] the threat of economic isolation as a weapon to force sister States to enter into even a desirable reciprocity agreement."[70] States may stand on more solid ground if they describe acceptable allowances by the attributes of the issuing plans rather than their origin, and if these attributes are justified by local non-protectionist purposes, such as public health.

Going it alone: single-state compliance

Although it may not prove as cost-effective, a state may want to implement a single-state compliance plan. Some plan design choices isolate a state automatically from a larger market; for instance, the CPP prohibits interstate trading with a rate-based state that applies "custom" rates to EGUs. EGUs with custom rates could only use ERCs generated by a resource registered in that state. Similarly, if a state requires EGUs to use a trading platform that is incompatible with other platforms, it would cut off its EGUs from the interstate allowance market. Alternatively, a state might just limit trading or ERC acquisition to in-state.

If a state has a strong local health interest in adopting a plan that will isolate the state from interstate trading, it could sustain a DCC challenge. For instance, a state might adopt custom rates for its EGUs to induce particularly dirty units to retire. That state should convince a court it is not discriminating against out-of-state interests but attempting to achieve a public health goal. To further demonstrate that the state is motivated by health concerns and not protectionist interests, the state should allow in-state ERC generators to register with other states to sell ERCs, and out-of-state ERC generators to register in the state.

If a court reaches *Pike* balancing, it might determine that benefits of improved local air quality outweigh burdens imposed on out-of-state EGUs that cannot access this state's ERC market.

A twist on this scenario is the California issue. California issues allowances for its pre-existing economy-wide greenhouse gas (GHG) emissions trading program.[71] Unless California carves out its EGUs from the rest of the program or submits its trading program as a "state measure" in its CPP plan, EPA could prohibit the state from exporting allowances to other CPP mass-based trading programs (because California's economy-wide cap exceeds its CPP budget).[72] Washington State is contemplating an economy-wide GHG trading program as well.[73]

States might also seek to cut off use of their allowances in certain states. Washington State's initial economy-wide GHG trading proposal would have accepted allowances from other states, including those participating in the northeast Regional Greenhouse Gas Inventory (RGGI) program. Since the CPP prohibits *export* of allowances from economy-wide programs, this proposal could result in a one-way flow of allowances into Washington.

While a rule similar to Washington's initial proposal should withstand a DCC challenge, states reacting to such a proposal by barring export of their allowances could face more risk. Of particular concern would be a plan that prohibits the sale of allowances to EGUs in another state until that state changes its law to allow the export of *its* allowances, or changes an element of its plan. This looks like states forcing sister states to behave in a particular way to gain access to a market.

Reducing leakage to new plants or other activity across state lines

EPA's primary leakage concern[74] is that within a mass-based plan, production could shift from existing units operating under a cap to new units not subject to a mass pollution limit.[75] (New coal and natural gas units are subject to carbon intensity standards under a different EPA rule, but not a cap on total emissions.) This shift could undermine the CPP's emission reduction goals. The CPP suggests two methods to address leakage to new sources:

(1) Include new sources under the cap (the CPP provides an "existing + new" cap for each state); or
(2) Allocate additional allowances to existing gas units that increase utilization, and to renewable energy generators, to make both cost-competitive with new, uncapped EGUs.[76]

Alternatively, states can explain why they do not believe leakage to new sources will occur.

Ignoring the efficacy of these set-asides, a heavily debated topic,[77] the in-state nature of the renewable energy set-asides and existing natural gas allocations could implicate the DCC. Yet an in-state set-aside should survive DCC scrutiny. Initial allocation of pollution allowances is not a market-based process, but the granting of permits to pollute provided by the state.[78] Moreover, the DCC generally does not prohibit subsidizing in-state actors.[79] That said, for other reasons states might choose to regionalize their set-asides.

A second type of interstate leakage may also occur – production could shift from EGUs under a mass-based plan to EGUs subject to a rate-based CPP plan. States with pre-existing carbon programs have worried about this interstate shift; for instance, California's greenhouse gas reduction statute[80] required the state to minimize interstate leakage by rule,[81] and RGGI states considered leakage rules.[82] EPA acknowledges interstate leakage could occur but adopts a "wait and see" attitude:

> [W]ithout a better understanding of the different mechanisms that states may ultimately choose to meet the emission guidelines, and how different requirements in different states may interact, the EPA cannot project every potential differential incentive that could lead to a loss of CO2 emission reductions. Therefore, once program implementation begins, the EPA will assess how emission performance across states may be affected by the interaction of different regulatory structures implemented through state plans.[83]

Still, states may want to address this potential issue now. To prevent interstate leakage, a state might require that an entity importing power retire emission allowances associated with that power. To avoid appearing discriminatory, the requirement must be no more stringent than allowance requirements for in-state EGUs. Meanwhile, requiring the in-state importer to retire allowances shields the state from extra-territorial challenges, because the rule does not control commerce occurring wholly outside the state.[84]

A state might also seek to prevent "resource shuffling" as a reaction to its regulation of imports. A resource shuffle involves a deal between a buyer in a capped state and a seller that sells to the capped state *and* uncapped states. Prior to the cap, the seller might have sold fossil-fuel fired electricity to buyers in the capped state. Now, the seller can sell emissions-free electricity to the buyer in the capped state, and shift fossil-fuel sales to buyers in uncapped states. The scheme would not achieve actual emission reductions.

A state's regulation of resource shuffling could be voided as extra-territorial, if it is interpreted to prevent wholly out-of-state sales of higher-emitting sources of electricity.[85] However, something like California's rule, which regulates in-state importers and a transaction to which they are a party[86] might survive a DCC challenge.[87]

A final potential challenge to leakage rules – or any state regulation of imported power – bears mentioning. Interstate businesses sometimes argue that multiple state laws create inconsistent obligations. For instance, a rate-based plan would require an EGU to surrender ERCs in the rate-based state in which it is located. Meanwhile, if that EGU served load in a neighboring state, and the neighboring state required the importer to surrender allowances covering the imported power, this would affect the power purchase price and in essence require the EGU to pay for compliance in two states. Challengers could argue this subjects interstate commerce to multiple and conflicting requirements, and is unduly burdensome. But "double regulation" is not a per se DCC violation, and a court would be reluctant to void state plans under *Pike*.

Challengers might also characterize the overlapping plan requirements as double taxation by two states. Challengers would have to convince a court that an emissions cap or performance standard is a tax. It is not clear they would succeed under the varying definitions of tax in different jurisdictions.[88] Even were they to clear this hurdle, fairly apportioned, non-discriminatory taxes would withstand DCC scrutiny.[89]

Limiting ERC eligibility in a rate-based plan

The CPP sets minimum eligibility requirements for ERCs used to adjust an EGU's emission rate. Some requirements, such as unique serial numbers and the use of EPA-administered or approved tracking systems, are meant to ensure that each ERC "represents one megawatt hour of actual energy generated or saved with zero associated emissions".[90] Other requirements describe the type of resources qualified to generate ERCs – natural gas-fired EGUs,[91] renewable sources like wind, solar, geothermal, and hydro, nuclear, combined heat-and-power, demand side energy efficiency,[92] and with additional documentation, qualified biomass, waste-to-energy, and carbon capture and sequestration (CCS).[93] The only geographic limitation EPA sets is that eligible ERC resources must be located in, or contract to provide power to, a rate-based state.[94]

Beyond this federal floor, states might limit ERC eligibility further. For instance, some states may choose not to accept ERCs from biomass or waste-to-energy generators. If a state can articulate a reason tied to its police powers – such as concern about local environmental impacts from this type of generation – and if the state applies this limit in a non-discriminatory manner, then it should prevail in any DCC challenge. On the other hand, if a state makes clear that it wants to develop an in-state wind industry and so submits a plan that will only accept ERCs from in-state wind generators, it could face a charge that it is discriminating against competing out-of-state sources of ERCs.[95]

Allocating allowances to EGUs in a mass-based plan

The CPP requires mass-based state plans to distribute allowances for each compliance period.[96] At the outset, states can decide to auction the allowances or distribute them for free. EPA gives states significant flexibility in initial allowance allocation. Even where EPA issues a federal plan, EPA proposed that a state could file a partial plan to allocate allowances while leaving the rest of the plan's administration to EPA.[97]

A state could argue that at this stage of the process, allowances are not "commerce" and so are shielded from DCC scrutiny. The fact that economists believe initial allocation should not affect allowance prices or market function supports this view.[98] Therefore, states may likely use allowance allocation to achieve local air quality, consumer protection, and other goals. For instance, a state might allocate allowances to non-emitters such as new renewable energy projects or distribution companies. These entities could sell the allowances and use the revenue to fund new zero-emitting generation or provide rate relief.

Even between affected EGUs, states might consider allocating allowances using factors such as historical or updated levels of production, age, service territory, or proximity to environmental justice communities. These choices do not implicate the DCC. An allocation scheme that gives preference to EGUs serving in-state retail customers poses the most potential DCC risk, but ultimately may be allowed, again on the grounds that initial allocation is not "commerce."

Conclusion: Suggestions for Minimizing Risk

With some consideration, states should be able to achieve their policy goals without running afoul of the dormant Commerce Clause.

- States can negotiate joint or linked plans with several other states without violating the DCC. They likely may not isolate other states for not adopting reciprocal plan elements.
- States may be able to prevent automatic linking to states with different plan elements, if they accept allowances for compliance based on plan attributes rather than origin, and if they can articulate non-protectionist, local health benefits for the attributes.
- States should be able to create their own single-state compliance plan.
- States can write rules to prevent leakage and resource shuffling, if those rules apply to in-state actors and place limits on imports that are equivalent to in-state requirements.
- Trading-ready states can limit ERC eligibility based on generator type but not origin.
- The DCC does not likely constrain choices related to initial allowance allocation.

ENDNOTES

[1] *Hillside Dairy, Inc. v. Lyons*, 539 U.S. 59, 66 (2003); *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 91-92 (1984); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 343 (1982).
[2] CPP Preamble, 80 Fed. Reg. 64,734.
[3] Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units (CPP) Preamble, 80 Fed. Reg. 64,662, 64,741 (Oct. 23, 2015).
[4] EPA Legal Memorandum Accompanying Clean Power Plan for Certain Issues, at 54 ("Interstate emissions trading programs that states may wish to develop under this rule similarly would not implicate the Commerce Clause").
[5] *Gibbons v. Ogden*, 22 U.S. 1 (1824).
[6] Some of this discussion is taken from Kate Konschnik and Ari Peskoe, Minimizing Constitutional Risk: Crafting State Energy Policies that Can Withstand Constitutional Scrutiny, Harvard Environmental Policy Initiative White Paper (2014).
[7] *Granholm v. Heald*, 544 U.S. 460 (2005).
[8] *Wyoming v. Oklahoma*, 502 U.S. 437 (1992).
[9] *New England Power Co.*, 455 U.S. 331.
[10] *See Transcanada Power Mrkting Ltd. v. Bowles*, C.D. Mass, Case No. 4:10-cv-40070, Complaint; *Amer. Tradition Inst. v. Epel*, D. Colo., Case No. 11-cv-00859, Complaint; *see also Illinois Commerce Comm'n v. FERC*, 576 F.3d 470 (7th Cir. 2009).
[11] Colorado S.B. 13-252.
[12] *Black Star Farms, LLC v. Oliver*, 600 F.3d 1225, 1230 (9th Cir. 2010); *see also Puppies 'N Love v. City of Phoenix*, 2015 WL 4532586, *10-12 (D. Ariz. 2015).
[13] *Alliance for Clean Coal (ACC) v. Miller*, 44 F.3d 591 (7th Cir. 1995); *ACC v. Bayh*, 72 F.3d 556 (7th Cir. 1995).
[14] See, e.g., *Miller*, 44 F.3d at 595 (calling Illinois' law a "none-too-subtle attempt" to drive use of Illinois coal).
[15] *Maine v. Taylor*, 477 U.S. 131, 138 (1986) (*citing Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979)).
[16] *Taylor*, 477 U.S. at 148; *Oregon-Washington R. & Nav. Co. v. Washington*, 270 U.S. 87, 96 (1926).
[17] *See, e.g., Sporhase v. Nebraska*, 458 U.S. 941, 956 (noting "a State that imposes severe withdrawal and use restrictions on its own citizens is not discriminating against interstate commerce when it seeks to prevent the uncontrolled transfer of water out of the State," but striking a law that banned export unless the receiving state granted reciprocity).
[18] *PPL Energyplus, LLC v. Hanna, 977 F.Supp.3d 372, 411-412 (D.N.J. 2013); see also PPL Energyplus, LLC v. Nazarian,* 974 F. Supp.2d 790, 853 (D. Md. 2012) (finding no discrimination in a similar scheme because the mere siting of a plant did not benefit that source in the wholesale market at the expense of out-of-state competitors*).*
[19] *See, e.g., Amer. Tradition Inst. v. Epel*, Civil Action No. 11-cv-00859, Def.'s Resp. to Pl.'s Early Mot. for Part. S.J., at 15-17 (filed Oct. 1, 2013).
[20] *Gen. Motors Corp. v. Tracy*, 519 U.S. 278 (1997); *see also Alaska v. Arctic Maid*, 366 U.S. 199 (1961).
[21] *Puppies 'N Love*, 2015 WL 4532586, at *10.
[22] *Gen. Motors Corp.*, 519 U.S. 278.
[23] CPUC Decision 11-12-052 (citing *Gen. Motors Corp.*, 519 U.S. at 298–299).
[24] *See United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmnt. Auth.*, 550 U.S. 330, 344-45 (2007).
[25] The Court "never intended to cut the States off from legislating on all subjects relating to the health, life, and safety of their citizens, though the legislation might indirectly affect the commerce of the country." *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 443-44 (1960) (*quoting Sherlock v. Alling*, 93 U.S. 99, 103 (1876)).
[26] *Atlantic Coast Demolition & Recycling, Inc. v. Bd. of Chosen Freeholders of Atlantic County*, 48 F.3d 701 (3d Cir. 1995).
[27] *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980).
[28] *White v. Massachusetts Council of Construction Employees, Inc.*, 460 U.S. 204 (1983). *See also McCarthy v. Philadelphia Civil Serv. Comm'n*, 424 U.S. 645 (1976) (upholding residency requirement for public employment); *Brooks v. Vassar*, 462 F.3d 341, 357 (4th Cir. 2006) (state-owned liquor store can choose to sell only in-state wines).
[29] *Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989).
[30] *Brown-Forman Distillers Corp. v. NY State Liquor Auth.*, 476 U.S. 573, 581 (1986).
[31] *Healy*, 491 U.S. at 336 (citing *Brown-Forman*).
[32] *SPGGC, LLC v. Blum*, 505 F.3d 183 (2d Cir. 2007).
[33] *Rocky Mountain Farmers Union v. Corey*, 730 F.3d 1070, 1101 (2013) ("In the modern era, the Supreme Court has rarely held that statutes violate the extraterritoriality doctrine.").
[34] *Energy & Environ. Legal Inst. v. Epel*, 793 F.3d 1169 (10th Cir. 2015); *Amer. Beverage Assn. v. Snyder*, 735 F.3d 362 (6th Cir. 2013) (Sutton, concurring); *Sam Francis v. Christie's*, 784 F.3d 1320 (9th Cir.) (Reinhardt, concurring).
[35] *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511, 521 (1935); *Brown-Forman,* 476 U.S. 573 (requiring the in-state price to be the lowest price for the next 30 days); *Healy* 491 U.S. 324 (requiring the in-state price to be the lowest price at the moment).

[36] *Sporhase*, 458 U.S. at 957; *The Great Atlantic and Pacific Tea Co., Inc. v. Cottrell*, 424 U.S. 366 (1976).
[37] *Edgar v. MITE Corp*., 457 U.S. 624, 642 (1982). The DCC portion of the opinion was only signed by a plurality of justices; however, in *Healy*, 491 U.S. at 333 n. 9, the Court noted this opinion with approval, describing it as "significantly illuminat[ing] the contours of the constitutional prohibition on extraterritorial legislation."
[38] *C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 393 (1994).
[39] *Rocky Mountain Farmers Union v. Corey*, 730 F.3d 1070, 1102 (9th Cir. 2013).
[40] *See, e.g., Healy*, 491 U.S. 336; *Huron Portland Cement Co. v. City of Detroit*, 362 U.S. 440, 448 (1960); *Freedom Holdings, Inc. v. Cuomo, 624 F.3d 38, 64-66 (2d Cir. 2010); S.D. Myers, Inc. v. City and County of S. Francisco*, 253 F.3d 461, 469-70 (9th Cir. 2001).
[41] *Rocky Mountain Farmers Union*, 730 F.3d 1070.
[42] *Id.*, at 1103 (citations omitted). Similarly, the Tenth Circuit upheld Kansas' regulation of internet payday loans, in part because Kansas stipulated that they would apply the regulation only to transactions involving a citizen in Kansas at the time of the transaction. *See Quik PayDay, Inc. v. Stork*, 549 F.3d 1302 (10th Cir. 2008).
[43] *North Dakota v. Heydinger*, 15 F. Supp.3d 891, 916-917 (D. Minn. 2014).
[44] *American Beverage Ass'n*, 735 F.3d at 367 (6th Cir. 2013).
[45] *North Dakota v. Heydinger*, No. 14-2156, 14-2251 (8th Cir. 2016).
[46] *United Haulers Ass'n, Inc.,* 550 U.S. at 346 (quoting *Philadelphia* v. *New Jersey*, 437 U. S. 617, 624 (1978)).
[47] *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 142 (1970).
[48] *Id.*
[49] *See, e.g., Raymond Motor Transp., Inc. v. Rich*, 434 U.S. 429 (1978) (striking a Wisconsin law restricting the length of interstate trucks, in part because state offered no evidence that shorter trucks provided other permissible local benefit such as safety). The Court has expressed discomfort at undertaking a fact-intensive inquiry to reach a *Pike* conclusion, an exercise usually reserved to lower courts. *See, e.g Dep't. of Revenue of KY v. Davis*, 553 US 328, 353 (2008).
[50] *Ark. Elec. Coop. Corp., v. Ark. Pub. Serv. Comm'n*, 461 U.S. 375 (1983).
[51] Arkansas' regulation of wholesale rates was not preempted by the Federal Power Act because the Act does not grant FERC jurisdiction over rates charged by cooperatives.
[52] *Town of Southold v. Town of East Hampton*, 477 F.3d 38 (2d Cir. 2007).
[53] *Union Elec. Co. v. EPA*, 515 F.2d 206, 211 (8th Cir. 1975), *aff'd*, 427 U.S. 246 (1976).
[54] 42 U.S.C. § 7423(a)(1), (b).
[55] *See, e.g., Envtl. Tech. Council v. South Carolina*, 98 F.3d 774 (4th Cir. 1996); *Asante v. Cal. Dep't of Health Care Servs.*, 2015 WL 9269666 (N.D. Cal. 2015); *Mary Hitchcock Memorial Hospital v. Cohen*, 2016 WL 1735818 (D.N.H. 2016).
[56] *Central Valley Chrysler-Jeep v. Witherspoon*, 456 F. Supp.2d 1160, 1173 (E.D. Cal. 2006).
[57] *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 44, (1980).
[58] *See, supra,* note 1.
[59] 42 U.S.C. § 7411.
[60] *US v. Southeastern Underwriters' Assn*, 322 US 533, 540 (1944) (superseded by statute).
[61] *Id.* at 549-550.
[62] Kirsten H. Engel, The Dormant Commerce Clause Threat to Market-Based Environmental Regulation: The Case of Electricity Deregulation, ECOLOGY L. QUARTERLY (1999) 26:243, at 259. *See also* id. at 259, note 44 (citing as analogy cases where states were unable to change the definition of "property" to avoid Fifth Amendment application).
[63] 80 Fed. Reg. 64,839; 40 C.F.R. § 60.5750(a).
[64] 80 Fed. Reg. 64,976–77. EPA took comment on whether an EPA-approved platform would suffice.
[65] 40 C.F.R. § 60.5750.
[66] *Great Atlantic & Pac. Tea Co.,* 424 U.S. at 378-79.
[67] *Northeast Bancorp, Inc. v. Governors of the Fed. Reserve Sys.,* 472 U.S. 159, 174 (1985) (emphasis added).
[68] *BMW of N. America, Inc. v. Gore*, 517 U.S. 559, 571 (1996) (citation omitted) (finding Alabama court could not set punitive damages based on acts in other states, particularly as the acts were allowed in other jurisdictions).
[69] *Philadelphia*, 437 U.S. at 626-27.
[70] *Id.*
[71] California Global Warming Solutions Act, A.B. 32 (2006).
[72] 80 Fed. Reg. 64,893-94.
[73] Washington Department of Ecology proposed clean air rule (June 1, 2016). An earlier proposal had suggested using RGGI allowances for compliance, while structuring the in-state compliance instrument in such a way as to render it unusable in other jurisdictions. See WDE Jan. 6. 2016 proposed clean air rule.

[74] Leakage has the potential to undermine the capped market by "'providing incentives to shift, rather than reduce, GHG emissions.'" Erin Parlar, Michael Babakitis, and Shelley Welton, "Legal Issues in Regulating Imports in State and Regional Cap and Trade Programs," Columbia Law School Policy Paper (Oct. 2012) (quote omitted).
[75] 80 Fed. Reg. 64,887-90; 64,914
[76] 80 Fed. Reg. 64,887-88, 90; 40 C.F.R. § 5790(a)(5).
[77] *See, e.g.*, MJ Bradley & Assocs., "EPA's Clean Power Plan: Survey of IPM Modeling Resource" (Jan. 13, 2016).
[78] Although, one could argue that when the generation set-asides are based on production, they impede the electricity market by making a recipient generator's bid more competitive.
[79] *See New Energy v. Limbach*, 486 U.S. 269, 278 (1988) ("The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the State's regulation of interstate commerce*. Direct subsidization of domestic industry does not normally run afoul of that prohibition").
[80] California AB 32; Cal. Health & Safety Code § 38562(b)(8) ("In adopting regulations . . . to the extent feasible and in furtherance of achieving the statewide greenhouse gas limits, the state board shall . . . minimize leakage").
[81] CCR 17 § 95802.
[82] RGGI, 2012. Program Review: Summary of Recommendations to Accompany Model Rule Amendments, at 3.
[83] 80 Fed. Reg. 64,890.
[84] *See, supra*, note 42.
[85] *See North Dakota v. Heydinger*, 15 F. Supp.3d 891. California's resource shuffling rule focuses on "First Deliverers of Electricity" and so targets in-state purchasers of power. *See, e.g.,* CCR 17 § 95802(a)(147) .
[86] *Rocky Mountain Farmers Union*, 730 F.3d at 1101.
[87] Some conclude this type of scheme is likely constitutional. *See* Parlar et al., at 24-37. No one has yet challenged California's resource shuffling regulations, perhaps because the exceptions are broad, *see* Danny Cullenward, "Leakage in California's Carbon Market: Preliminary Trading is Consistent with Expected Impacts of Regulatory Changes," UC Berkeley working paper (updated June 21, 2014), or because the state has not yet enforced these provisions, *see* Van Ness Feldman, "New and Emerging Developments in California's Cap-and-Trade Program will have Significant Impacts on Western Power Markets," Jan. 14, 2014.
[88] *See*, Ari Peskoe, "Designing Emission Budget Trading Programs under Existing State Law," at 10-12.
[89] *See Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977).
[90] 40 § 60.5790(c)(2); details on tracking system at § 60.5810.
[91] 40 § 60.5795.
[92] 40 § 60.5800(a)(4).
[93] 40 § 60.5800(d).
[94] 40 § 60.5800(a)(3).
[95] *See, supra*, at 3 (noting states sued over in-state RPS requirements and preferences have amended their laws).
[96] 40 § 60.5815(b).
[97] 80 Fed. Reg. 65,026 ,65,029.
[98] Robert W. Hahn and Robert N. Stavins, "The Effect of Allowance Allocations on Cap-and-Trade System Performance," 54 J. OF LAW AND ECON. S267, Nov. 2011; Dallas Burtraw, David McLaughlin, and Sarah Jo Szamelan, Resources for the Future, "California's New Gold: A Primer on the Use of Allowance Value Created under the CO2 Cap-and-Trade Program," May 2012.