Title
Constitutional Implications of Regional CO2 Cap-and-Trade Programs: The Northeast Regional Greenhouse Gas Initiative as a Case in Point

Journal
UCLA Journal of Environmental Law and Policy, 27(2)

Author
Funk, William

Publication Date
2009

DOI
10.5070/L5272019578

Constitutional Implications of Regional CO_2 Cap-and-Trade Programs: The Northeast Regional Greenhouse Gas Initiative as a Case in Point

*William Funk**

I. INTRODUCTION

For eight years the Bush administration avoided addressing global warming, first denying its existence, then denying its anthropogenic contributions, and finally denying the government's legal ability to combat it. There is a new administration, however, and Presidential candidate Obama campaigned in favor of a national cap-and-trade program. Nevertheless, there are many matters of critical importance on the U.S. Congress' plate, and as of this writing Senate Majority Leader, Harry Reid, was hoping to take up climate change legislation by the end of the summer of 2009. The chances of passage even then are not clear. Economic woes and Republican opposition could still do it in.

This political reality suggests that existing and proposed regional cap-and-trade programs may have continuing importance. Consequently, the constitutional implications of these programs are worthy of consideration. The Regional Greenhouse Gas Ini-

* Robert E. Jones Professor of Law, Lewis & Clark Law School.

tiative (RGGI) is already in effect in ten northeastern and mid-Atlantic states,[1] while the Western Climate Initiative and Midwestern Regional GHG Reduction Accord are still far from operational. This Article considers three possible constitutional issues with regard to a regional cap-and-trade program, focusing on the RGGI: preemption, the Compact Clause, and the Dormant Commerce Clause.

II.
The RGGI

The RGGI is a cooperative undertaking of ten states[2] that began in 2005 with a Memorandum of Understanding.[3] In 2006 the RGGI developed a Model Rule.[4] Each state undertook to cap overall CO_2 emissions from electrical generating plants in the state in accordance with the RGGI Model Rule.[5] In essence, beginning in 2009 and lasting until 2014, the cap is set at the estimated amount of emissions in 2008. Thereafter, the cap is decreased by 2.5 percent each year until 2018, for a total decrease in emissions of 10 percent from the 2008 baseline.

Each fossil-fuel-fired electric generating unit serving a generator of twenty-five MW or larger must possess sufficient allowances for its emissions in any compliance period. Most of these allowances are sold at auction, and the purchasers can freely trade them on the market. Those who need more allowances to cover their emissions will need to buy them; those that possess more than they need may sell them. The money generated by the auctions will be used to fund energy conservation, energy efficiency, and clean energy programs.

The RGGI also allows for the assignment of "offset allowances" to generating facilities for certain types of projects that reduce or sequester greenhouse gas emissions in areas outside of electrical generation. Currently, only five types of

1. Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Delaware, and Maryland. Reg'l Greenhouse Gas Initiative, Participating States, http://www.rggi.org/states (last visited Mar. 18, 2009).

2. *See generally* Reg'l Greenhouse Gas Initiative, About RGGI, http://www.rggi.org/about (last visited Mar. 18, 2009).

3. Reg'l Greenhouse Gas Initiative, Memorandum of Understanding (Dec. 20, 2005), *available at* http://rggi.org/docs/mou_final_12_20_05.pdf.

4. Reg'l Greenhouse Gas Initiative, Model Rule (2006), *available at* http://www.rggi.org/docs/Model%20Rule%20Corrected%208.15.06.pdf.

5. Reg'l Greenhouse Gas Initiative, Model Rule (revised Dec. 31, 2008), *available at* http://www.rggi.org/docs/Model%20Rule%20Revised%2012.31.08.pdf.

projects can qualify for offset allowances.[6] Generally no more than 3.3 percent of a facility's allowances can be offset allowances.[7] There are strict application and verification processes to qualify an offset. An offset project may be located in any state, not just a RGGI state, if the other state has a cooperating regulatory agency that has entered into a Memorandum of Understanding with the RGGI states to provide oversight of the offset projects in that state.

The RGGI is implemented by each state enacting its own laws, which must conform to the RGGI Model Rule, to govern the generating facilities in its state.[8] RGGI, Inc., a nonprofit corporation, was created to provide technical and administrative services to the RGGI states. The allowance auctions are performed by World Energy Solutions, Inc., which operates online exchanges for energy and green commodities, and Potomac Economics, which performs monitoring and competitive assessment of wholesale electricity markets in the United States, oversees the auction.

III.
PREEMPTION

California's attempt to regulate CO_2 emissions of automobiles was challenged by local automobile dealers in part on the grounds that federal law preempted individual state regulation of greenhouse gases because such regulation would interfere with the President's negotiations with foreign powers to achieve a global agreement on the control of greenhouse gases.[9] The argu-

6. They are: landfill methane capture and destruction; reduction in emissions of sulfur hexafluoride (SF_6); sequestration of carbon due to afforestation; reduction or avoidance of CO_2 emissions from natural gas, oil, or propane end-use combustion due to end-use energy efficiency in the building sector; and avoided methane emissions from agricultural manure management operations. Reg'l Greenhouse Gas Initiative, Offsets, http://www.rggi.org/offsets (last visited Mar. 18, 2009).

7. *Id.*

8. New York State did not enact any new statute, believing that existing legislation was sufficient authority for its regulatory agency to adopt as regulations the requirements contained in the Model Rule. This belief has been challenged in a recently filed suit seeking to set aside New York's participation in the RGGI. *See* Petition and Complaint, Indeck Corinth, L.P. v. Paterson, (N.Y.S. Jan. 29, 2009) [hereinafter *Indeck Corinth*], *available at* http://www.globalclimatelaw.com/uploads/file/InDeck%20Complaint.pdf.

9. *See* Cent. Valley Chrysler-Jeep, Inc. v. Goldstene, 529 F. Supp. 2d 1151 (E.D. Cal. 2007) (rejecting claim that California's regulation of carbon dioxide from automobile emissions was preempted by executive's foreign policy regarding regulation of greenhouse gases).

ment was that the United States could better persuade other non-Kyoto nations to participate in a global agreement if the United States could maintain it would only agree to address greenhouse gas emissions if these other nations also agreed to address them. If, however, individual states began to regulate greenhouse gas emissions on their own, this would undercut the United States' bargaining position. There is some authority for state law being preempted on the basis of Presidential negotiations with foreign nations. For example, in *Am. Ins. Co. v. Garamendi*,[10] the Supreme Court held that a California law imposing certain requirements on foreign insurance companies that did business in Germany during the Holocaust interfered with the President's negotiations with the German government for reparations for Holocaust survivors.

Nevertheless, the court rejected the automobile dealers' argument on two separate grounds. First, the court found "no evidence" that it was United States policy to prevent states from taking any action to reduce greenhouse gas emissions, so that the United States could "speak with one voice" in foreign negotiations.[11] Second, even if there were such evidence, the court held that the California automobile emission regulation would not constitute a "clear conflict" with U.S. foreign policy sufficient to result in preemption of the state law under the authority of *Garamendi*.[12] The court noted that all past cases finding preemption of state law because of conflict with United States foreign policy involved state laws directed at foreign nations or nationals, whereas California's regulation of California automobile emissions had no relation to foreign nations or nationals. The court's analysis seems sound. Moreover, it is unlikely that the present administration would support a claim that state attempts to restrict greenhouse gases interfere with its foreign policy.

At least one case has found a state law regulating pollutant emissions preempted by the Clean Air Act.[13] New York enacted a law that effectively prohibited New York utilities from selling SO_2 offsets to upwind states under the Clean Air Act's acid rain cap-and-trade program.[14] This law clearly interfered with the

10. 539 U.S. 396 (2003).

11. *See* Goldstene, 529 F. Supp. 2d at 1186-89.

12. *Id.*

13. Clean Air Mkts. Group v. Pataki, 338 F.3d 82 (2d Cir. 2003) (holding that a NY statute requiring offsets purchase was preempted by the Clean Air Act's Acid Rain program).

14. *See* 42 U.S.C. § 7651 (2008).

federal Act's "emission allocation and transfer system"[15] and consequently was preempted by the federal law. However, here it is not apparent how the RGGI requirements could possibly interfere with the federal Acid Rain program or any other part of the Clean Air Act.

Finally, a recently filed case[16] challenging New York's participation in the RGGI asserts that RGGI is preempted by the Public Utility Regulatory Policies Act (PURPA).[17] An electric generator is suing New York's Public Service Commission (PSC) claiming that it will refuse to allow the company to pass through the increased cost of purchasing allowances, thereby violating the company's ability to recover the "fully avoided costs" to which it is entitled as a "qualifying facility" under PURPA.[18] Whatever claim Indeck Corinth may have to recover its "fully avoided costs," it is clear that RGGI is not preempted on this basis. Nothing in RGGI precludes the PSC from allowing qualifying facilities to pass through increased costs. The fault, if there is one, lies with the PSC, not RGGI. Indeed, the theory behind RGGI supports emitters being able to pass through increased costs, which will reduce the demand for electricity.

As may be seen, RGGI does not raise serious preemption problems under existing law, despite possible claims to the contrary. Of course, when—or if—Congress passes a federal cap-and-trade program for greenhouse gases, the preemption issue will almost certainly be dealt with explicitly. Congress is not unaware of the various regional cap-and-trade programs, and early bills on the subject have evidenced a clear intent to exempt state or regional cap-and-trade programs from federal preemption, so long as the state or regional program is stricter than the federal program.[19] Moreover, RGGI itself contains an explicit provision to sunset if a comparable federal program is enacted.[20]

15. 42 U.S.C. § 7651(b).

16. *See supra* note 8.

17. 16 U.S.C. §§ 2601-2645 (2008).

18. *See Indeck Corinth*, *supra* note 8, at 21.

19. *See*, *e.g.*, Section 1731 of the Boxer Amendment to S. 3036, 110th Cong., at 154 Cong. Rec. S5101 (2008).

20. *See*, *e.g.*, Memorandum of Understanding, § 6(C) (Dec. 20, 2005), *available at* http://rggi.org/docs/mou_12_20_05.pdf.

IV.
COMPACT CLAUSE

Article I, § 10, cl. 3, of the U.S. Constitution says that "no state shall, without the consent of Congress . . . enter into any agreement or compact with another state. . . ." By its terms it would seem that the Constitution requires the RGGI states to obtain congressional consent for the RGGI agreement. Nevertheless, those states have not sought or obtained consent.

Despite the seemingly clear language of the Constitution, however, the U.S. Supreme Court in 1893 opined that the Compact Clause should not be read literally.[21] Rather, it should be read in context to mean that "the prohibition is directed to the formation of any combination tending to the increase of political power in the states, which may encroach upon or interfere with the just supremacy of the United States."[22] In short, agreements that do not encroach upon federal sovereignty do not require consent. This test has been restated and applied to the current day.[23]

The most recent case to provide an extended explanation and application of this test is *United States Steel Corp. v. Multistate Tax Comm'n*.[24] There the issue was whether the Multistate Tax Compact (Compact), which had not been approved by Congress, was valid. The Compact was drafted in 1966 in light of the fact that traditional state tax administration was inefficient and costly as applied to multistate businesses. The Compact stated four purposes:

> (1) facilitating proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes; (2) promoting uniformity and compatibility in state tax systems; (3) facilitating taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and (4) avoiding duplicative taxation.[25]

To achieve these purposes it created the Multistate Tax Commission (Commission), made up of the tax commissioners of the Compact states. The Compact authorized the Commission:

---

21. *See* Virginia v. Tennessee, 148 U.S. 503 (1893).

22. *Id.* at 519.

23. *See, e.g.*, Northeast Bancorp, Inc. v. Bd. of Governors of the Fed. Reserve Sys., 472 U.S. 159, 175 (1985).

24. 434 U.S. 452 (1978).

25. *Id.* at 456.

(i) to study state and local tax systems; (ii) to develop and recommend proposals for an increase in uniformity and compatibility of state and local tax laws in order to encourage simplicity and improvement in state and local tax law and administration; (iii) to compile and publish information that may assist member States in implementing the Compact and taxpayers in complying with the tax laws; and (iv) to do all things necessary and incidental to the administration of its functions pursuant to the Compact.[26]

In addition, at the request of Compact states the Commission performs audits on behalf of the states and has the power of compulsory process in a Compact state.[27] While the Commission may adopt uniform regulations, they are advisory only and do not have effect in a state unless the state specifically adopts them.[28] Information obtained as a result of a Commission audit may only be disclosed in accordance with state law, and all substantive tax laws remain within the purview of the states, not the Commission.[29] Finally, any state can at any time withdraw from the Compact.[30]

Applying the *Virginia v. Tennessee* test to these facts, the Court found no requirement for congressional consent to this Compact, although this was the first compact not consented to by Congress that created a separate multistate entity. The Court could find nothing in the Commission that would encroach on the supremacy of the federal government.[31] Nothing in the Compact enabled the states to exercise any authority they could not exercise in its absence.[32] Nor did any state surrender any sovereign power to the Commission.[33] The Court rejected claims that the Compact encroached upon federal sovereignty with respect to interstate commerce,[34] noting that the only powers involved were "nothing more than reciprocal legislation" by the member states.[35] The Court also rejected a claim that the Compact impaired the sovereign rights of nonmember states by exerting undue pressure upon them to join the Compact.[36] The Court

26. *Id.* at 456-57.
27. *Id.* at 457.
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.* at 472-73.
32. *Id.* at 473.
33. *Id.*
34. *Id.* at 473-76.
35. *Id.* at 476.
36. *Id.* at 477-78.

concluded that "[a]ny time a State adopts a fiscal or administrative policy that affects the programs of a sister State, pressure to modify those programs may result,"[37] but this by itself does not affront the sovereignty of those sister states. Finally, the Court made clear that the fact that the subject matter of the Compact might touch on federal interests (here, taxation of multistate and multinational corporations) did not mean that the Compact was a threat to federal supremacy.[38] The federal government retained full power to legislate in the area and preempt the state laws and the Compact. Even if the Compact made it *politically* more difficult to enact preemptive legislation, that difficulty arose not from the Compact itself, but from the number of states involved in a similar undertaking.[39]

If one applies this analysis to the RGGI, similar conclusions seem to be indicated. Clearly, RGGI does not limit the federal government's authority to regulate CO_2 in any way it sees fit. Like the Commission, RGGI, Inc.—the entity created to support development and implementation of the RGGI program—does not impinge on federal supremacy. No state has delegated its sovereign powers to RGGI, Inc., nor can RGGI, Inc. exercise any powers over the states. It acts at most in a ministerial and advisory capacity, much like the Commission. All of RGGI's actual powers stem solely from individual states' laws, which—as was the case under the Compact—are "nothing more than reciprocal legislation" with no capacity to bind other member states.

This similarity between RGGI and the Compact suggests that RGGI does not violate the Compact Clause because it lacks congressional consent. While some commentators have reached similar conclusions,[40] at least one commentator has reached a different conclusion,[41] and a Compact Clause claim is part of the Indeck Corinth challenge to RGGI.[42] The Indeck Corinth Complaint, however, contains little legal analysis to support its claim. Presumably its briefs will be more illuminating. In arguing that

37. *Id.* at 478.

38. *Id.* at 479 n.33.

39. *Id.*

40. *See* Note, *The Compact Clause and the Regional Greenhouse Gas Initiative*, 120 HARV. L. REV. 1958 (2007) (concluding RGGI does not violate Compact Clause); Comment, *The Regional Greenhouse Gas Initiative and the Dormant Commerce Clause: Analysis and Recommendations* (2008) (on file with author) (accord).

41. *See* Note, *United We Stand: The Interstate Compact as a Tool for Effecting Climate Change*, 41 GA. L. REV. 229, 249-54 (2006) [hereinafter *United We Stand*] (concluding that RGGI does violate the Compact Clause).

42. *See Indeck Corinth*, *supra* note 8, at 22-23.

RGGI violates the Compact Clause, the Georgia Law Review Note relies heavily upon policy arguments contained generally in books written before the Commission case.[43] Moreover, it misunderstands (or mischaracterizes) some of the features and effects of RGGI, which is understandable in that the note was written before RGGI was fully formed.[44] For example, the note suggests that RGGI would impose "forced limits on factory emissions."[45] RGGI, of course, does not affect factories, only electricity generators. In addition, the note states that "RGGI establishes regional environmental legislation typically belonging to federal jurisdiction."[46] This, however, is not an accurate description of RGGI. The CO_2 caps are by state, and the legislation is by states and limited to states. There is no "regional law" established by RGGI. It is literally "nothing more than reciprocal legislation" by the member states. In short, the note's attempt to distinguish RGGI from the Compact by suggesting RGGI interferes with interstate commerce, does not exist solely between the agreeing states, and infringes on the rights of non-participating states[47] is not supported by the actualities of the RGGI agreement.

Perhaps the strongest predictor of the validity of RGGI notwithstanding the lack of congressional consent is the fact that of the hundreds of interstate agreements and compacts that have been adopted in our nation's history *not one has ever been found to have been required to have congressional consent* despite numerous challenges to agreements and compacts brought in both state and federal courts. It appears that the Compact Clause, like the Non-Delegation Doctrine,[48] has become a restriction in theory, but in practice the restriction rarely applies.

43. *See United We Stand*, *supra* note 41, at ns. 170-192.

44. A less forgivable mistake is factual errors as to cited authorities. For example, the Note states: "Courts have held agencies established by compact closely connected to interstate commerce require congressional consent." *United We Stand*, *supra* note 41, at 252. It then cites FREDERICK L. ZIMMERMAN & MITCHELL WENDELL, THE LAW AND USE OF INTERSTATE COMPACTS 23 (1976). That authority, however, nowhere states that any court has ever required congressional consent with respect to a particular compact or compact agency. The authority merely indicates its authors' view that such agencies "might have difficulty in operation . . . without Congressional consent." *Id.* And, of course, this view was expressed before the Multistate Tax Commission case, where the Court made clear that the presence of federal interests did not by itself require congressional consent.

45. *See United We Stand*, *supra* note 41, at 252.

46. *Id.* at 254.

47. *See id.*

48. *See generally* Whitman v. Am. Trucking Ass'ns, Inc., 531 U.S. 457 (2001).

V.
THE DORMANT COMMERCE CLAUSE

The Dormant Commerce Clause prohibits states from discriminating against interstate commerce except where absolutely necessary to address a local problem.[49] Discrimination is never allowed merely to protect local industry.[50] In its basic structure nothing in RGGI raises a Dormant Commerce Clause issue, but there are two aspects of RGGI that potentially raise a concern.

A. *Offsets*

As mentioned earlier, RGGI provides that generators may obtain offset allowances to satisfy a small portion of their total allowance requirements. Generators may engage in projects themselves or purchase offset allowances from an independent entity engaging in the project. Model Rule XX.10.3(a) limits the location of offset projects to participating states or nonparticipating states whose regulatory agency has entered into a memorandum of understanding to carry out certain obligations, including auditing and enforcement of offset terms. By distinguishing between participating states and nonparticipating states, the Model Rule facially discriminates against interstate commerce in offsets. Normally such discrimination would result in a law being a violation of the Dormant Commerce Clause. Here, however, two factors may save such a distinction.

First, the restriction is not protectionist in intent or effect. It is clearly designed to assure the same adequate monitoring and enforcement of out-of-region offset projects as in-region projects will receive from their own state. Second, cases such as *Dean Milk v. City of Madison*[51] suggest that reasonable attempts to provide equivalent out-of-state safeguards as are provided with

49. It might be argued that global warming is not a "local" problem, so that states may not justify any burden on interstate commerce in order to fight global warming. The recent Supreme Court decision in *Massachusetts v. EPA*, 549 U.S. 497 (2007), however, suggests that the Court will accept the validity of a state interest in addressing global warming. There, the issue was whether Massachusetts suffered the requisite injury from global warming to justify standing to challenge EPA's failure to regulate CO_2 emissions from automobiles. In addition to finding that Massachusetts suffered an actual, local injury – sea level rise – the Court also suggested that states have a quasi sovereign interest in protecting its citizens. While not directly addressing the idea of a "local" interest for Dormant Commerce Clause purposes, this analysis suggests that states have a "local" interest in addressing global warming through restrictions on CO_2 emissions.

50. *See generally* West Lynn Creamery, Inc. v. Healy, 512 U.S. 186 (1994).

51. Dean Milk Co. v. Madison, 340 U.S. 349 (1951).

respect to in-state entities are not discriminatory merely because they differ in certain ways or involve an added cost attributable to the difficulty of out-of-state enforcement.

In *Dean Milk*, the city of Madison, Wisconsin, enacted an ordinance forbidding the sale of pasteurized milk in Madison unless it was processed and bottled within five miles of the center of Madison. The Court held that this law was facially discriminatory against interstate commerce, so it asked whether the ordinance was enacted for a legitimate government purpose and, if so, whether there was any less discriminatory means by which to achieve that purpose. The city said that it needed to inspect the processing facilities in order to assure the health and safety of consumers of the milk. Protecting the health and safety of consumers, the Court held, was clearly a legitimate purpose, but there were less discriminatory alternatives to a ban on milk from out-of-area processors. First, the Court said that the city could send its inspectors to more remote areas and charge the actual and reasonable cost of such inspection to the importing processors. Second, the Court said that Madison could rely on inspections by the authorities in the jurisdiction where the milk was processed, assuming that those inspectors would apply uniform and adequate inspections. The requirement in RGGI for offsets in nonmember states to undergo the same type of validation procedures as offsets in RGGI states would appear similar to the suggestions of the Court in *Dean Milk*. If so, the RGGI requirement for nonmember states to have an MOU agreeing to engage in the requisite auditing and enforcement would not be a violation of the Dormant Commerce Clause.

B. *Leakage*

The RGGI program does not place any limitations on the importation of electricity from outside the RGGI area. Thus, electricity generated outside the RGGI area without regard to its associated CO_2 emissions can be imported and sold within the RGGI area. Because generators within RGGI must have allowances for their CO_2 emissions, which will increase their costs, there may be an economic advantage to Load Serving Entities (LSEs), or electricity distributors, to import "dirty" electricity rather than pay the higher price for "clean" electricity generated within the RGGI area. In other words, while the cap on CO_2 emissions within the RGGI states might be met, it might be only the result of a displacement of electricity that would have been generated within RGGI states by electricity imported from non-RGGI states, generated without regard to its CO_2 emissions. In short, in a worst case, there would be no overall reduction in CO_2 emissions as a result of the RGGI cap. This phenomenon is known as "leakage." Obviously, if the purpose of RGGI is to combat global warming by reducing CO_2 emissions, leakage is a problem.

Recognizing this potential problem, the RGGI states undertook a study of its projected magnitude and potential responses to the problem.[52] One conclusion was that the amount of leakage that might occur is highly debatable, so that the first priority should be to establish a tracking system that would enable an accurate determination of actual leakage occurring under RGGI. This poses no Dormant Commerce Clause problems.

The Leakage Study expressed the belief that a national cap-and-trade program would be established in the not-too-distant future, and the national program would essentially substitute for the regional cap-and-trade programs like RGGI and thereby eliminate the problem of leakage.[53] Consequently, the Leakage Study recommended the adoption of leakage mitigation measures that could be adopted in the short term. These measures would involve the reduction of overall electricity demand by a variety of means, such as the implementation of energy efficiency portfolio standards, the harmonization across the RGGI region of the most up-to-date building energy codes and standards for commercial and residential buildings, the harmonization across the RGGI region of the most up-to-date appliance and equipment energy efficiency standards, and the development and implementation of policies and market incentives to reduce market barriers to combined heat and power and other clean distributed generation.[54] Again, these in-state actions would raise no Dormant Commerce Clause issues.

52. *See* REG'L GREENHOUSE GAS INITIATIVE, POTENTIAL EMISSIONS LEAKAGE AND THE REGIONAL GREENHOUSE GAS INITIATIVE (RGGI) (2008) [hereinafter LEAKAGE STUDY], *available at* http://rggi.org/docs/20080331leakage.pdf.

53. Actually, a national program does not totally eliminate problems of leakage. First, electricity is transmitted across national borders, so the same type of leakage that can occur in a regional program can occur in a national program. Second, a form of leakage occurs when the manufacture of products dependent on electricity moves to unregulated jurisdictions where the price of electricity is lower, and then the products are imported into the United States, displacing the products that would have been manufactured here.

54. *See* LEAKAGE STUDY, *supra* note 52, at 4-5.

The Leakage Study then identified two additional categories of measures to deal with leakage, both of which would be more difficult to implement. The first would directly address carbon emissions and could include:

> 1) Carbon procurement adder: an analytical tool that requires a load-serving entity (LSE) planning its electricity supply resource acquisitions to incorporate a "shadow price" for carbon emissions into its financial analysis of different investment options;
>
> 2) Carbon procurement emissions rate: a limit placed on the emissions rate of power supplied to an LSE through a long-term power purchase agreement; and
>
> 3) Emissions portfolio standard: a policy mechanism that would require an LSE to meet an average, output-based emissions standard (lbs. CO_2/MWh) for the portfolio of supply resources the LSE uses to provide retail electricity.[55]

While these measures are difficult to administer, they also do not raise Dormant Commerce Clause problems because they do not impose any distinctions based upon where power is generated and places requirements only on LSE's within the member state.

The other category of measures to address leakage would be the adoption of a "load-based emissions cap-and-trade program." In essence, this would be a substitution for RGGI's current generator-based emissions cap-and-trade program. Under this substitute program, there would be a cap on the emissions related to all electricity delivered for retail sale by an LSE. The LSE's would be the entities required to have allowances, rather than the generators. As stated in the Leakage Study, "[t]his approach would be effective in addressing the majority of any potential emissions leakage. Assigning a carbon cap to LSEs eliminates the ability of LSE procurement decisions in response to the RGGI program to contribute to incremental emissions increases from generation not subject to a carbon constraint."[56] Again, this category of measures would not seem to raise Dormant Commerce Clause problems, because the regulation would be only on entities (the LSEs) within the RGGI states, and the calculation of the emissions related to the electricity they provide would not differ between generators within or without RGGI. In short, there would be no discrimination either facially or in effect

55. *Id.* at 6.
56. *Id.* at 7.

against interstate sales of electricity or against out-of-RGGI sellers of electricity. The Leakage Study does note, however, that there are relatively insurmountable practical and legal obstacles to this category of measures, not the least of which would be the need for each RGGI state to enact new legislation authorizing such a program.

The Leakage Study actually recommends only the first of these three categories—reduction of electricity demand—because of its relatively easy implementation and the expectation of a relatively quick substitution of RGGI by a national cap-and-trade program. Nevertheless, none of the categories of measures to deal with leakage addressed in the Leakage Study raise Dormant Commerce Clause issues. There are, however, alternatives not addressed in the Leakage Study that do raise such issues.

Probably the most obvious solution to leakage, albeit having its own practical implementation problems, would be to ban importations of electricity from generators not subject to equivalent cap-and-trade programs. This facial discrimination would almost surely violate the Dormant Commerce Clause because it would impose the most extreme burden on interstate commerce (a ban) in order to achieve the local purpose, when a less discriminatory option was equally available—the load-based emissions cap described above.

The other alternative that would raise Dormant Commerce Clause issues would be a so-called hybrid approach. The hybrid approach would require LSEs to obtain allowances for any power purchased from outside RGGI. This would also be facially discriminatory and could be upheld, if at all, only under the theory underlying the compensatory tax doctrine. That doctrine derives from the case of *Henneford v. Silas Mason*,[57] where Washington State imposed a use tax on goods imported into the state that did not pay the state retail sales tax. As described by the Supreme Court, this doctrine states that, if a facially discriminatory tax imposed on interstate commerce is the rough equivalent of an identifiable and substantially similar tax on intrastate commerce, the tax will not offend the Dormant Commerce Clause.[58] To identify whether a state tax is such a compensatory tax, the Court has established a three-part test.

57. Henneford v. Silas Mason Co., 300 U.S. 577 (1937) (upholding Washington State's use tax on imported goods to compensate for the State's sales tax against a dormant commerce clause challenge).

58. *See* Or. Waste Sys., Inc. v. Dep't of Envtl. Quality, 511 U.S. 93, 102-03 (1994).

First, the state must identify the intrastate burden it is attempting to compensate. Second, the tax must be shown to be roughly equivalent to that burden. Third, the events on which the taxes are imposed must be so substantially equivalent as to be proxies for one another.[59]

We can apply this test to the hypothetical of a RGGI state requiring in-state LSEs to purchase allowances for purchases of electricity generated out-of-state under circumstances that would have required allowances if generated in-state. First, the intrastate burden would be the greenhouse gases emitted by the non-RGGI generator resulting from the substitution of lower-cost non-RGGI electricity for electricity generated within RGGI and requiring allowances. Second, the allowances the LSE would be required to purchase for non-RGGI electricity would exactly equate to the allowances required for in-state generators. Third, while the allowances for in-state generators would be on the basis of electricity generated and the allowances required for LSEs would be on the basis of electricity purchased, these "events" are "substantially equivalent as to be proxies for one another," much as a tax on "use" is substantially equivalent to a tax on sale. Arguably, therefore, the hybrid approach could meet the compensatory tax doctrine test.

This conclusion, however, is less than certain.[60] While in one sense the hybrid approach meets the "common theme running through the cases in which [the] Court has sustained compensating taxes [:] [e]qual treatment of interstate commerce,"[61] the hybrid approach differs from these cases in that it does not involve an attempt by the RGGI state to obtain funds for itself. That is, the allowance requirement that would be imposed on in-state LSEs purchasing non-RGGI electricity would not generate funds for the state or make up for funds that it would otherwise receive if the LSEs purchased electricity governed by RGGI. It would instead be imposing a financial burden on the purchase of non-

59. *See id.* at 103.

60. *Compare* Heddy Bolster, Note, *The Commerce Clause Meets Environmental Protection: The Compensatory Tax Doctrine as a Defense of Potential Regional Carbon Dioxide Regulation*, 47 B.C. L. REV. 737 (2006) (suggesting the rationale of the compensating tax cases could be applied to charges applied to out-of-state generators) *with* Jeffrey Miller, Comment, *The Regional Greenhouse Gas Initiative and the Dormant Commerce Clause: Analysis and Recommendations* (2008) (suggesting that a hybrid approach to allowances would have difficulty meeting the compensatory tax test, because it is not a tax).

61. Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 243 (1987) (quoting Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 331 (1977)).

RGGI electricity simply to place it on an equal footing with RGGI electricity. This would not be "protectionist" in the classic sense, because the RGGI program has no preference for RGGI generators per se. That is, RGGI's interest is in reducing CO_2 emissions overall, from wherever. It is not trying to protect RGGI generators from non-RGGI competition; it is simply trying to assure the reduction of CO_2 emissions at a cost to RGGI consumers.

Nevertheless, the hybrid approach has a certain aura of the dread "protectionism" because it would be raising the costs of non-RGGI generated electricity to equalize the costs of in-RGGI generated electricity. In that regard, the effect of the hybrid approach has uncomfortable correspondence with the milk pricing system involved in *Baldwin v. G.A.F. Seelig, Inc.*,[62] which the Supreme Court found violated the Dormant Commerce Clause. In *Baldwin*, in order to maintain a steady and secure milk supply, New York had instituted a minimum price to be paid by milk dealers to in-state milk producers. Because this law would raise the price of New York milk to milk dealers, leading them to look to out-of-state producers for milk, New York prohibited the sale in New York of imported milk purchased at a price below the New York minimum price, effectively requiring New York milk dealers to pay the same price for imported milk as it would pay for New York milk. This was viewed as a violation of the Dormant Commerce Clause because it was "designed to neutralize advantages belonging to the place of origin."[63] Of course, the only advantage belonging to the other states was that they did not believe it necessary as a matter of public policy to take regulatory action to maintain price floors for milk. Here, the required purchase of allowances by LSEs for non-RGGI electricity would be to neutralize the advantage belonging to the non-RGGI states—the advantage of not believing it necessary as a matter of public policy to limit CO_2 emissions from its power plants.

Finally, with respect to the hybrid approach, it is well to note that the Supreme Court has never upheld a non-tax fee under the compensating tax doctrine, even when it might have seemed applicable.[64] The Court has been very strict in limiting that doctrine to taxes.

62. Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935).
63. *Id.* at 527.
64. *See, e.g.*, Or. Waste Sys., Inc., 511 U.S. at 103-04, n.6 (1994).

VI.
Conclusion

The above discussion has assessed the likely constitutional questions that might be raised with respect to RGGI or similar regional greenhouse gas initiatives. It concludes that under current law neither RGGI nor a similar regional greenhouse gas initiative would be preempted by federal law. The potential for preemption under a new federal cap-and-trade program depends entirely on what that legislation provides, but some of the previous bills for federal cap-and-trade programs have explicitly exempted state programs from preemption.

This Article also concludes that RGGI is not invalid as an interstate compact lacking congressional consent. Rather, RGGI appears to be an example of a long line of interstate agreements that do not require consent because they do not encroach upon the full and free exercise of federal authority. Indeed, it would be slightly incredible for RGGI to be the very first interstate agreement invalidated under the Compact Clause of the U.S. Constitution.

Finally, the Article assesses the restrictions of the Dormant Commerce Clause on RGGI's treatment of offsets for projects outside of RGGI as well as on RGGI's potential responses to leakage. The Article concludes that the special requirements attendant to validation of offsets for projects outside of RGGI is not likely to violate the Dormant Commerce Clause, because those special requirements seem narrowly tailored to the particular problems associated with projects in non-RGGI states in a manner designed to fit within the criteria suggested by the Supreme Court in *Dean Milk*. The Article also concludes that the Dormant Commerce Clause poses no obstacle to the suggested response to leakage—increased energy conservation—nor would the other measures to address leakage considered by the Leakage Study violate the Dormant Commerce Clause. However, two other possible responses—a ban on the purchase of out-of-RGGI electricity generating CO_2 emissions and the hybrid approach—would either clearly violate the Dormant Commerce Clause or at least raise serious Dormant Commerce Clause problems.