Minimizing Constitutional Risk

Crafting State Energy Policies that Can Withstand Constitutional Scrutiny

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States stand on the front lines of our nation’s energy policy. State regulatory authority over in-state activities is pervasive, extending from resource extraction to utility ratemaking. Alongside this authority, the federal government has historically asserted jurisdiction over matters that cross state boundaries, such as air pollution, interstate energy sales, and nationwide efficiency standards. As markets have become increasingly interconnected across state lines, the historic jurisdictional boundaries set by the Constitution and Congress have become harder to discern.

For example, the electricity industry’s current structure and the deployment of new technologies and services may not fit neatly within the confines of the Federal Power Act’s jurisdictional language, written by Congress eighty years ago. Moreover, because electricity and other energy markets are not confined to a single state, a state’s ability to influence how energy is produced, transported, and used is less clear.

Since 2008, constitutional challenges to state energy policies have been filed in more than a dozen states. Legal disputes are highlighting the uncertainties about state and federal energy authority. Challengers argue that state policies are impermissibly regulating or discriminating against interstate commerce, or that state authority in this area is preempted by Federal law. Most of the challenges target state electricity policies, such as incentives for new gas-fired generation, mandates that utilities purchase renewable energy, limits on coal-fired power, and feed-in tariffs for new renewable generation. Other lawsuits seek to overturn a state law limiting lifecycle greenhouse gas emissions of transportation fuels, city ordinances providing incentives for hybrid taxis, and a state building code offering incentives for installing high-efficiency appliances.

These lawsuits need not halt State clean energy policy-making. Rather, they can help policymakers recognize the constitutional limits of state power and appreciate the risks of the tools available to achieve desired policy goals. Armed with this understanding, policymakers can identify alternative strategies for achieving the same policy goals, and assess strategies for relative constitutional risk. This paper applies the key constitutional doctrines to state energy policies, summarizes recent lawsuits, and suggests ways for states to work within constitutional limits to achieve policy goals while minimizing the risk of a constitutional challenge. The paper’s Legal Appendix provides background about the key constitutional doctrines and four federal statutes that have been the subjects of recent preemption challenges.
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Minimizing Constitutional Risks of State Energy Policies: Lessons from Recently Filed Lawsuits

A. Minimizing Dormant Commerce Clause Scrutiny

The Commerce Clause of the U.S. Constitution grants Congress the authority to “regulate commerce . . . among the several states and with the Indian tribes.” As discussed in more detail in the Legal Appendix, courts have read into this authority a restriction on state activity that interferes with interstate commerce. Although the extent of the restriction on state authority continues to be a matter of debate, courts typically subject a state law to three inquiries:

1) Does the law discriminate against out-of-state interests?
2) Does the law regulate commerce occurring wholly outside the state’s boundaries?
3) Does the law impose a burden on interstate commerce that is “clearly excessive in relation to the putative local benefits?”

“In all but the narrowest circumstances,” courts will strike down a state law that discriminates by mandating differential treatment of in-state and out-of-state competing economic interests in a way that benefits the former and burdens the latter.  The Legal Appendix includes several examples of discriminatory laws and state taxes or fees that have been struck down by courts as unconstitutional. The prohibition on discriminatory laws is the most well-established aspect of the dormant Commerce Clause case law.

The second inquiry, about extraterritorial regulation, has been invoked recently by plaintiffs in several challenges to state energy laws. For example, plaintiffs in Colorado argue that the state’s renewable portfolio standard is unconstitutional because it “projects Colorado law and policy outside of the borders of Colorado and regulates out-of-state production practices.” If applied to regional energy markets, this application of the dormant Commerce Clause could significantly limit the reach of state energy policy.

However, the Supreme Court has rarely struck down a State law because of its extraterritorial reach. Nonetheless, every federal Circuit, except for the Fifth, has adopted a dormant Commerce Clause analysis that considers extraterritoriality. The precise application of the extraterritorial inquiry — and indeed the appropriateness of the inquiry — will continue to vary and be a subject of debate until the Supreme Court provides clarification.

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a 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.”); see also American Beverage Ass’n v Snyder, 735 F.3d 362 (6th Cir. 2013) (Sutton, J., concurring) (“I am not aware of a single Supreme Court dormant Commerce Clause holding that relied exclusively on the extraterritoriality doctrine to invalidate a state law.”).
If a law survives the first and second inquiry, a court may subject it to a balancing test to answer the third inquiry. This fact-based inquiry requires a court to balance a law’s burden on interstate commerce against its local benefits. The court must consider the “nature of the local interest involved, and [ ] whether it could be promoted as well with a lesser impact on interstate activities.” Although the Supreme Court recently expressed skepticism about whether a court is suited to conduct this test, this inquiry remains part of the Court’s dormant Commerce Clause analysis. Because the inquiry is fact-intensive, it is hard to draw general conclusions about how a law can survive this test.

Recent lawsuits may be trying to capitalize on the uncertainty surrounding certain aspects of the dormant Commerce Clause doctrine. Even if unsuccessful, these lawsuits can unsettle the energy regulatory landscape, potentially delaying investments and deployment. Part A of this document is intended to assist states in limiting litigation’s chilling effect and crafting policies that are more clearly permissible under dormant Commerce Clause doctrine.

1. **Preference for In-State Industry: Mandates or Regulatory Incentives for In-State Production**

   **Summary and Conclusions:**
   - A number of states have enacted policies that require utilities to procure energy from generators located within the state’s boundaries.
   - Some of these policies have been challenged as discriminatory. States have responded to recent lawsuits by modifying their statutes or regulations to remove explicit in-state preferences for renewable energy.
   - If the state, rather than a utility or other private entity, is the buyer, geographic discrimination is permissible.
   - If a state policy is motivated by reasons other than economic protectionism, such as improving grid reliability or reducing pollution, locational limitations may be permissible.
   - States should avoid rationalizing locational limitations based on economic benefits.

   **Legal Background:** A Renewable Portfolio Standard (RPS) or Renewable Energy Standard typically requires companies selling electricity to end-use customers to generate or purchase a specific percentage of their energy from renewable sources. As of 2014, twenty-nine states and the District of Columbia have similar policies on their books; an additional nine states and two territories have renewable portfolio goals. In a number of cases, states have required that utilities purchase a certain percentage of this renewable energy from renewable generators in the state, region, or utility service territory. Other states have given utilities “bonus” credits towards compliance for purchasing in-state renewable generation.

   Recent challenges have sought to strike in-state restrictions from an RPS. Courts have not reached a decision on these claims; however, in response to filed lawsuits, a few states have
modified provisions that were challenged as discriminatory. In Massachusetts, regulators issued emergency rules to suspend the in-state requirement from a statute that required distribution utilities to sign long-term contracts with renewable generators located in Massachusetts (see below).\textsuperscript{10} Missouri regulators never finalized a provision that would have required utilities to meet their RPS obligations with in-state renewables.\textsuperscript{11} The Colorado legislature amended the State’s RPS to remove the phrase “in Colorado” from provisions offering REC bonuses for various resources, incentives to utilities for investments in renewable energy, and mandates that utilities procure energy from certain resources.\textsuperscript{12}

While courts have not reached the merits of these issues, the Seventh Circuit observed that the requirement in Michigan’s RPS that utilities meet the mandate only with energy generated in Michigan “trips over an insurmountable constitutional objection. A state cannot, without violating the Commerce Clause, discriminate against out-of-state renewable energy.”\textsuperscript{b} On the other hand, a mandate for energy from a resource that is not available in all states, such as off-shore wind, could well be constitutional, although the Supreme Court has never directly addressed this issue.\textsuperscript{13}

Legal Challenge: Massachusetts Removes In-State Mandates from Renewables Law

Massachusetts’ RPS requires investor-owned utilities and retail electricity suppliers to generate or procure 15% of their retail sales from Class I renewable sources by 2020.\textsuperscript{14} A 2008 law directed Massachusetts utilities to enter into long-term contracts for renewable energy with in-state generators.\textsuperscript{15} The law also required that a portion of the RPS come from small in-state generators.\textsuperscript{16} Massachusetts regulators then created an in-state solar REC (S-REC), a certificate generated by in-state solar installations, and set a high alternative compliance payment for retailer suppliers that failed to hold sufficient S-RECs. The higher compliance payment had the effect of boosting the value of S-RECs as compared to other RECs.

In April 2010, TransCanada, an in-state retail supplier that also owns wind generation facilities located in Maine, filed a lawsuit in federal court arguing that Massachusetts discriminated against interstate commerce by requiring (1) distribution utilities to sign long-term renewable power contracts with in-state generators, and (2) retail suppliers to hold S-RECs from in-state solar projects.\textsuperscript{17} Massachusetts suspended the in-state contract requirement in emergency regulations,\textsuperscript{18} and settled with TransCanada by agreeing to allow projects under existing contracts to count towards the solar mandate.\textsuperscript{19} Notably, Massachusetts did not change the in-state solar requirement.

\textsuperscript{b} Illinois Commerce Comm’n v. FERC, 721 F.3d 764 (7th Cir. 2013). The case was about FERC’s approval of a MidContinent ISO tariff amendment. Michigan’s RES was not at issue in the proceeding, and was not struck down.
**Work-Around: Use the Market Participant Exception**

**Summary and Conclusions:**
- Based on Supreme Court case law, a state could favor in-state renewable energy generation if the state directly participates in the electricity market.
- An RPS implemented through centralized state-run procurement might meet the ‘market participant’ exception.

New York’s Energy Research and Development Authority (NYSERDA) implements the state’s Renewable Portfolio Standard (RPS). The state agency procures Renewable Energy Credits (RECs) using funds collected from utility ratepayers to meet a statewide annual target set by the Public Service Commission.\(^c\)

In 2013, acting on a NYSERDA petition, the New York Public Service Commission (PSC) authorized NYSERDA to limit RPS eligibility to in-state renewable energy generation and off-shore wind interconnected to New York’s grid. The PSC reasoned that because NYSERDA is the only purchaser of RECs for New York RPS compliance, a New York REC is not “an article of interstate commerce” and in fact there is no “market” for purposes of a dormant Commerce Clause analysis.\(^20\) Instead, the PSC found the REC amounts to a permissible State subsidy.\(^d\)

Hydro-Quebec petitioned for rehearing, arguing that in fact a REC market exists — RECs are used by consumers to demonstrate that they are purchasing renewable energy. The PSC affirmed its prior ruling but changed its reasoning. Now, the PSC found that New York could limit participation in the REC market to in-state generators because NYSERDA is a “market participant.” As the Supreme Court has recognized, a state participating in a market as a “purchaser, seller, or producer,”\(^21\) rather than a regulator, may favor its own citizens.\(^22\)

According to the PSC, this exception allows NYSERDA, a public benefit corporation established under New York’s State Public Authorities Law and the sole purchaser of RECs for RPS compliance, to restrict its REC purchases to those generated by in-state renewable projects. No one has challenged this final order in court.

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\(^c\) Illinois’ RPS is also implemented through centralized procurement. The Illinois Power Agency manages the procurement of wholesale electricity, including renewable energy to meet the State’s RPS, for two investor-owned utilities. However, unlike NYSERDA, the Illinois state agency does not purchase the RECs itself, but instead brokers contracts between utilities and suppliers. It is not clear whether the market participant exception applies to such a centralized management of utility procurement.

\(^d\) As noted in the Legal Appendix, while there may not be an economic difference between a tax on out-of-state businesses and a subsidy to in-state businesses, courts have typically not subjected subsidies to the same level of scrutiny under the dormant Commerce Clause.
Work-Around: Base Locational Distinctions on a Rationale Unrelated to Economic Protectionism

Summary and Conclusions:
- States might be able to include locational requirements in renewable energy policies to ensure that the ensuing renewable energy will benefit the state’s ratepayers.
- For example, states may have reasons other than economic development, such as relieving transmission congestion, which could justify locational requirements.

Some potential benefits of renewable energy are contingent on the location of the generation. A State may be able to include locational requirements that are based on these non-economic benefits. For example, electricity generated by renewable sources can displace fossil-fuel fired generation, which uses large amounts of water²³ and emits pollution that is harmful to human health.²⁴ Locally sited renewable generation could displace in-state fossil fuel generation and reduce local air pollution and water use.

The California Legislature adopted this reasoning in its RPS,⁶ which requires utilities to procure renewable energy from generators that connect to a California balancing authority.²⁵ In rejecting a dormant Commerce Clause challenge to its implementing regulations, the California Public Utilities Commission (CPUC) asserted that many out-of-state generators can connect to California and that the rules do not create any preference for those located within California’s boundaries.²⁶ The CPUC’s rules were not challenged in court.

States may be able to require or encourage utilities to purchase types of renewable energy that are inherently local and therefore likely to occur in-state. For instance, RPS programs with a requirement for distributed generation could result in utilities having to purchase in-state renewable energy. States may be able to point to legitimate non-protectionist reasons for this carve-out. Distributed resources can reduce peak demand, system losses, the need for investment in new infrastructure, and transmission congestion, any and all of which may reduce retail prices paid by in-State ratepayers.²⁷

For example, Colorado law requires that utilities meet a portion of their RPS obligations through distributed generation, including a specific requirement for retail (behind the meter) distributed generation. Following the filing of a legal challenge, Colorado cut the words “in Colorado” from a number of RPS provisions.²⁸ Challengers argued that the distributed generation requirement was discriminatory because it amounted to a de facto “in Colorado”

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⁶ The Legislature found that “[s]upplying electricity to California end-use customers that is generated by eligible renewable energy resources is necessary to improve California’s air quality and public health . . .” (Pub. Util. Code, § 399.11, subd. (e)(1)).

²⁵ Similar, States that are located in multi-State RTOs may be able to justify requirements that energy be deliverable to the RTO region.
requirement. In federal court, Colorado argued that retail distributed generation offers several benefits, including reducing energy losses due to long-distance transmission, improving reliability, and reducing peak demand. The court held that plaintiffs did not have standing to challenge the distributed generation requirement and so did not issue a decision on the merits (see page 21 for more on standing).

States should be careful not to rationalize otherwise appropriate locational requirements based on economic benefits. To garner political support for a measure, legislators and regulators may want to tout the in-state or local economic benefits that might accrue from a mandate for in-state energy production. Instead, locational requirements should be tied to the non-economic benefits of the requirement. For example, if a state finds that distributed energy resources can lower peak demand and lower ratepayer costs if they are located within a utility service territory, the law should state those benefits and require that the resource be located in the service territory, rather than in the state. While promoting in-state economic benefits is politically attractive, this approach may backfire in the face of a constitutional challenge.

For instance, while a district court relied on the rule’s default “carbon intensity scoring” to find that California’s Low Carbon Fuel Standard was discriminatory on its face (see pages 10 and 20 for a more detailed description of this litigation), the court also appeared influenced by the promulgating agency’s description of possible impacts. The court quoted agency documents predicting that the regulation could lead to the construction of refineries “in the state,” which would “provide needed employment [and] an increased tax base for the state.” The agency explained that these “benefits will be more important in rural areas of the State that are short on employment but rich in natural resources.”

Similarly, courts have cited language about local economic benefits in a Hawaiian statute to protect locally manufactured alcohols and statements in Illinois and Indiana statutes announcing each law’s purpose as preventing utilities from switching out in-state coal for low-sulfur western coal, as a basis for finding these laws discriminated against out-of-state competitors on their face.

Legal Challenge: Federal District Courts Do Not Strike Down Locational Requirements in New Jersey and Maryland

In 2012, generators filed separate lawsuits challenging a Maryland Public Service Commission order and a New Jersey law that required distribution utilities to sign contracts with the developers of new natural gas-fired power plants. Maryland’s order required that the new plant be located in a particular PJM region, 98 percent of which is in Maryland. The New Jersey law established a system for evaluating potential projects that treated in-state projects more favorably. The primary motivations behind both actions were to ensure in-state reliability and lower electricity prices.
Federal district courts in Maryland and New Jersey rejected dormant Commerce Clause challenges, but found that the Federal Power Act preempted both schemes because they interfered with the wholesale price of electricity (See page 16 for a summary of the preemption argument). The Maryland court found that the requirement that the plant be located in a particular region of the PJM interstate electricity market, as opposed to within the boundaries of Maryland, does not save the order from Commerce Clause scrutiny. However, the court then found that the Maryland order did not discriminate against interstate commerce because the new natural gas plant would still have to compete in the regional electricity market, and the order does not erect any barriers or provide any competitive advantages based on location. Moreover, the court found that “Maryland has a legitimate interest in ensuring that Maryland residents have available to them an adequate and reliable supply of electric energy.” Therefore, under the Pike test, this non-protectionist interest outweighed any burdens on interstate commerce.

Likewise, the New Jersey court found that the challengers could not overcome the “persuasive evidence” that “reliability issues could only be resolved in one of two ways – transmission . . . or additional generation in or near the location where the reliability issue will occur” [emphasis in original]. . . . As such, it appears reasonable that the [New Jersey] Board would incentivize construction in areas where reliability concerns are in flux.” Therefore, the New Jersey court found that the challengers had not established unconstitutional discrimination. The Third and Fourth Circuits upheld these lower court decisions based on the Supremacy Clause and did not opine on the Commerce Clause challenges.

2. Preference for In-State Industry: Taxes or Fees

Summary and Conclusion:
- As discussed in the Legal Appendix (page 25), state taxes may not discriminate against interstate businesses.
- A Systems Benefits Charge (SBC) or similar item on a utility bill could be a mechanism for subsidizing in-state energy projects, but courts have not provided guidance on this issue.

State taxes must adhere to dormant Commerce Clause doctrine. A discriminatory tax is not allowed, even if it is motivated by a purpose other than economic protectionism.

No recently filed lawsuit challenges a state tax per se. However, a lawsuit filed in Ohio argues that a state energy fund that collects RPS alternative compliance payments distributes money in a discriminatory manner. The group supports its argument by analogizing Ohio’s program to a Massachusetts scheme that subsidized in-state milk producers with interstate taxes and that the U.S. Supreme Court held violated the dormant Commerce Clause.
A citizens group in Ohio is challenging the state siting board’s approval of the construction of a wind farm. The group raises numerous claims under state law and argues that the board’s approval is defective because it was premised on a utility purchasing the wind farm’s energy to meet the state’s RPS. According to the lawsuit, the RPS is not a proper basis for approval because it is unconstitutional. At the time of the approval, the RPS included a mandate for in-state generation.

The RPS also provides that a utility or retail supplier in Ohio that fails to procure sufficient energy to meet its RPS target must submit alternative compliance payments into the state’s advanced energy fund that supports projects in Ohio. The group argues that the scheme is unconstitutional under the Supreme Court decision *West Lynn Creamery*.

In that case, a Massachusetts milk dealer challenged a state pricing order requiring each reseller of milk to make payments based on the amount of milk it sold. Massachusetts distributed the proceeds to in-state milk producers; the resulting subsidy more than offset the original payment. In promulgating the pricing order, state regulators acknowledged that out-of-state milk producers had lower costs than Massachusetts producers, which would be forced out of business unless their competitors’ prices went up. The Court held that the scheme was unconstitutional because resellers’ payments were “effectively a tax which makes milk produced out of state more expensive.” The Court noted that although the tax itself was not discriminatory, the coupling of the tax with payments only to Massachusetts producers “create[s] a program more dangerous to interstate commerce” than the tax or subsidy alone.

The connection to interstate commerce is more attenuated in the Ohio RPS fund than in the milk scheme at issue in *West Lynn Creamery*. The milk subsidy was funded by a tax levied on resellers based on the volume of wholesale milk procured from producers in Massachusetts and other states. In Ohio, the source of the funds is compliance payments paid by in-state utilities that fail to buy sufficient renewable energy to meet the State RPS. Therefore, the Ohio payments are not connected to any commercial transactions but are instead directly tied to a utility’s failure to comply with state law.

*Workaround: Structure Tax-Subsidy Schemes so only In-State Entities are “Taxed” for In-State Services*

Many states subsidize in-state energy projects through System Benefits Charges (SBC) or similar items on ratepayers’ utility bills. An SBC is similar to a tax because all ratepayers must pay the...
charge, and the charge is mandated by state law. However, an SBC can be distinguished from a tax on interstate commerce. Generally, the nature of an SBC is inherently intrastate; the charge appears on bills that an in-state utility sends to in-state customers for in-state purchases. Moreover, an SBC can further be insulated from interstate commerce when a utility calculates it based on in-state services such as distribution of energy over local wires, rather than on retail sales that are more closely connected to interstate commerce.

Revenue collected through the SBC is typically collected in a state-administered fund and then be distributed to various energy projects. Under some state laws, SBC revenue is distributed only to in-state projects. Such in-state discrimination is likely lawful because a state may use taxes on in-state services to benefit its own citizens.

3. Regulation of Wholly Out-of-State Activities and Actors

Summary and Conclusions:

- Courts will typically strike down a state law that regulates commerce occurring wholly outside the boundaries of the state.
- Pending cases illustrate that an extraterritorial analysis can turn on whether a state law can be read to place mandatory legal obligations on out-of-state entities or control out-of-state transactions.
- State policies that place legal obligations only on in-state entities, such as utilities selling power to in-state retail customers, should be safe from extraterritorial challenges.
- Courts have recently held that a law encouraging but not requiring out-of-state entities to conform their conduct to state law is not extraterritorial regulation.

As discussed in the Legal Appendix (page 28), when analyzing a claim that a state law regulates extraterritorially, a court’s inquiry is focused on whether the statute directly controls conduct in another state. A key part of that inquiry is determining whether the law places legal obligations on entities operating in other states. If the law places legal obligations on out-of-state entities, the law may be vulnerable to a legal challenge.

A federal district court struck down Minnesota’s law banning imported electricity from new coal plants because the statute’s prohibition applied to any “person.” According to the court, because the prohibition is not limited to persons in Minnesota, the statute’s plain language could apply to entities buying and selling power wholly outside of Minnesota’s borders. Given the interstate nature of the electric grid, the court reasoned that a generator in neighboring North Dakota could be importing coal-fired electricity incidentally into Minnesota in violation of the statute, even if Minnesota distribution companies and consumers had not
purchased its power. The court concluded that the law’s practical effect is to “control non-Minnesota entities’ conduct occurring wholly outside of Minnesota.”

On the other hand, a federal district court upheld Colorado’s Renewable Energy Standard, holding that it “only regulates Colorado energy generators and the companies that do business with Colorado energy generators.” The court determined that the law does not apply to transactions between two out-of-state entities and does not impose conditions on the importation of electricity into Colorado.

The critical difference between the laws in Minnesota and Colorado is whether the law places mandatory legal obligations on out-of-State entities. In Minnesota, the law placed legal obligations on a “person” engaging in certain conduct. As noted, the court found the law unconstitutional because the unrestricted term “person” could be used by Minnesota regulators to control the conduct of out-of-state entities. The Colorado statute places legal obligations only on Colorado utilities and out-of-state generators that “freely choose[] to do business with a Colorado utility.” According to the Colorado court, a voluntary incentive that induces an out-of-state generator to conform its conduct to Colorado law does not violate the dormant Commerce Clause. Similarly, California’s narrow definitions of regulated entities have helped two state initiatives survive dormant Commerce Clause challenges.

**Legal Challenges: Ninth Circuit holds that Low Carbon Fuel Standard Does Not Regulate Extraterritorially; FERC Says Including California Cap and Trade Requirements in Interstate Electricity Market Is Constitutional**

**Low Carbon Fuel Standard:** To comply with California’s Low Carbon Fuel Standard (LCFS), California fuel blenders must purchase ethanol that on average does not exceed carbon intensity (CI) limits. California assigned default carbon intensity values to different types and sources of ethanol. “Differences in CI scores are based on [California’s] assessment of [other] states ‘farming practices …; crop yields; harvesting practices; and collection and transportation of the crop.’” California’s system tracked the federal government’s standards for “greenhouse gas life cycle” analyses.

In 2011, a federal district court ruled that the LCFS violated the dormant Commerce Clause, in part because it “impermissibly regulates extraterritorially.” The court found that by considering how ethanol was produced and transported to the point of sale in California, the LCFS sought to regulate wholly out-of-state activities. The Court also found that requirements like the LCFS could Balkanize national ethanol markets or lead to inconsistent regulation.

The Ninth Circuit reversed. The appellate court noted the distinction between “laws ‘that regulate out-of-state actors directly’ from those that ‘regulate[] contractual relationships in which at least one party is located in [the regulating state]’.” Moreover, the court found that
California did not control ethanol production or transportation in other states; the state merely considered the effect of these factors in its life cycle analysis. As for the district court’s Balkanization concern, the Ninth Circuit noted, “[i]f we were to invalidate regulation every time another state considered a complementary statute, we would destroy the states’ ability to experiment with regulation.” The Ninth Circuit remanded the case and instructed the district court to determine whether the LCFS discriminates in purpose or effect and if not, to apply the *Pike* balancing test. The remand is pending.

GHG Adders in CAISO Market: In 2014, a similar issue in California was brought before FERC. California law requires importers of electricity to hold allowances representing the carbon emissions associated with that energy. In June 2014, FERC approved the creation of a new electricity market operated by the California ISO that stretches outside the state’s boundaries into other Western states. The market rules permit a generator outside of California to include a bid adder with its energy bid to cover the cost of the GHG allowances. If a generator does not want to comply with the carbon emissions rules, it can include a very high bid adder to indicate that it does not want to serve California but will serve customers in other states. A market participant had requested that FERC reconsider its approval of the new market rules. One of its objections to this scheme is that it is an “impermissible intrusion and burden by a state program on interstate commerce.” FERC rejected that argument, noting that participation in the new market is voluntary and that the market participant had failed to explain how incorporating California’s requirement into the FERC-jurisdictional market violates the dormant Commerce Clause.

B. Avoiding Preemption by Federal Law

In some areas of energy regulation, Congress has provided federal agencies with exclusive jurisdiction. Under the Supremacy Clause, state laws that encroach on this federal space are preempted. In other areas, federal agencies and states share responsibility, and states are allowed to supplement a federal standard or take a different approach from the federal regime. State law can still be preempted if it conflicts with federal statute or regulation.

The federal laws most likely to overlap or conflict with states’ energy regulation — the Federal Power Act, PURPA, Clean Air Act, and Energy Policy and Conservation Act — are discussed in the Legal Appendix. Part B of this document highlights state energy policies at issue in recent preemption challenges or FERC orders. For some policies, there are “workarounds” that may enable state law to avoid preemption.

1. Incentives for Electricity Generation

To spur investment in electric generation capacity, a state can choose from a number of policy options to incentivize new construction. States can use standard economic development
incentives, such as tax exempt bond financing or property tax relief, provided they design such incentives within the confines of the dormant Commerce Clause doctrine.

States also have policy options that are specific to electricity generation. However, as discussed in the Legal Appendix, a significant limitation on state authority is that Congress granted FERC exclusive jurisdiction to regulate wholesale power sales. State regulation of wholesale rates is therefore generally field preempted. This section examines three policies that may amount to impermissible wholesale rate making if not designed to avoid preemption: mandating feed-in tariffs, guaranteeing generator revenue in regions with federally regulated auction markets, and pricing renewable energy credits (RECs).

**Designing a Feed-In Tariff**

**Summary and Conclusions:**
- A feed-in tariff (FiT) is a standard offer contract that a utility must offer to any generation facility that meets certain criteria, such as generation technology and capacity.
- Utilities may voluntarily offer a FiT, and a state could mandate that utilities offer a FiT for generation facilities owned by a state or local government. A state could also establish a FiT for municipal or cooperative utilities. The Federal Power Act does not grant FERC jurisdiction over those entities.
- A FiT mandated by state law can be preempted unless it is designed within the parameters established by PURPA.

**Legal Background:** In the Federal Power Act, Congress granted FERC exclusive jurisdiction to regulate wholesale power sales. A state-mandated feed-in tariff (FiT) that includes a rate set by the state may therefore be field preempted. It may also be conflict preempted because federal regulation of wholesale sales is “premised on contractual agreements voluntarily devised by regulated companies.” Those freely negotiated contracts for wholesale power must be filed with FERC before going into effect. Under long-standing precedent, FERC presumes that negotiated contracts are “just and reasonable.” Required contracts with a mandated rate are not “freely negotiated” and therefore may conflict with the federal regulatory scheme.

**Workaround:** Design a FiT within the parameters set by PURPA

**Summary and Conclusions:**
- States can avoid preemption by structuring a FiT that comports with PURPA.

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\(^{h}\) PPL Energy Plus v. Hanna, 977 F.Supp.2d 372,404 (D. N.J. 2013) (stating that the parties agreed that the state could support construction of a new gas-fired power plant by providing tax exempt bond financing, granting property tax relief, signing favorable leases on state-owned land, gifting environmentally damaged properties for brownfield development, or accelerating permit approvals.
According to FERC, PURPA allows states to set wholesale rates for renewable energy that reflect the costs of energy generated by renewable sources and that account for avoided emissions and other benefits, provided they reflect “real costs” to the utility.

How PURPA Works: As described in the Legal Appendix, PURPA is an exception to the FPA restriction on state wholesale ratemaking. PURPA requires utilities to purchase energy and capacity from a “qualifying facility” at a rate that does not exceed the utility’s “avoided cost.” A qualifying facility is either a renewable generator smaller than 80 megawatts or a co-generator that meets certain efficiency requirements. A PURPA avoided cost rate is based on the cost of energy that a utility would have to buy but for the energy generated by the qualifying facility. State regulators set utility-specific rates, which FERC is “reluctant to second guess” because those determinations are “by their nature fact-specific.”

FERC has explained that because states have authority to dictate a utility’s purchasing decisions they can also determine what particular generators are displaced through purchases from a qualifying facility. If a state requires a utility to procure energy from certain types of generators, such as renewables, those types of generators provide the basis for calculating a utility’s avoided cost for that procurement requirement.

PURPA therefore permits (but does not require) a “tiered” avoided cost rate structure to address states’ tiered procurement mandates. For example, a utility in a state with an RPS may have to procure energy from two tiers of generators. One tier is defined by the RPS, and the second tier consists of all other sources that the utility relies on to maintain adequate service. An RPS could have more than one tier if it includes a solar carve-out or other mandates for energy from a particular type of renewable source.

A PURPA-Compliant FiT: Under a multi-tier avoided-cost structure in a state with an RPS, the state can require utilities to pay renewable energy “qualifying facilities” a rate related to the cost of energy from the renewable generator being avoided by the qualifying facility. In other words, if new renewable energy is more expensive than electricity avoided from natural gas, coal, or legacy hydro generators, a state can set a separate “renewable energy” avoided cost rate that is based on the cost of RPS-eligible generation. The rate may also include avoided environmental, transmission, or other costs, provided those costs are “real costs that would be incurred by utilities.” States have adopted several different methodologies for calculating avoided cost rates, which can result in the calculation of very different avoided cost rates.

Setting a multi-tiered avoided-cost rate structure is not without risk. Although FERC has endorsed this approach, a court hearing a challenge to a state’s avoided-cost rates would not be required to agree with FERC’s legal conclusions.
Exception: Utilities May Apply for an Exemption from PURPA’s Purchase Requirement

In light of changed competitive dynamics in the generation market since PURPA’s enactment, Congress amended the statute in 2005 to allow utilities with access to competitive markets to apply for an exemption from the requirement to purchase from qualifying facilities. FERC’s implementing regulations establish a rebuttable presumption that utilities that are members of an RTO or ISO should be relieved of their obligation to purchase energy from qualifying facilities larger than 20 megawatts. For facilities smaller than 20 megawatts, a utility must demonstrate that each facility has nondiscriminatory access to competitive markets.

Legal Challenges: Developers Challenge FiTs in Vermont and California

Vermont Program: From 2009 to 2012, Vermont’s Sustainably Priced Energy Enterprise Development (SPEED) program provided a FiT for qualifying facilities smaller than 2.2 megawatts. Qualifying facilities could choose to participate in SPEED and get a state-mandated rate that was not based on avoided cost, or they could instead take the avoided cost rate that had long been available to qualifying facilities in Vermont. In 2013, an auction mechanism set the SPEED rate.

In 2013, Otter Creek, a two megawatt solar facility in Vermont, filed a complaint with FERC arguing that SPEED amounted to illegal wholesale ratemaking and is preempted by the Federal Power Act. FERC decided not to exercise its discretionary enforcement authority. FERC found that Otter Creek had suffered no harm from the optional SPEED program and that developers could choose to take Vermont’s avoided cost rate instead of participating. According to FERC, a qualifying facility may voluntarily agree to any rate it finds acceptable. Otter Creek did not file suit in Federal court.

California Program: As required by state law, each of California’s three investor-owned utilities has a renewable market adjusting tariff (ReMAT). The tariff is available to facilities smaller than three megawatts and registered with FERC as qualifying facilities. The tariff rate was initially based on the results of an auction for new renewable capacity, and can be adjusted every two months based on market prices. Each utility offers the adjusted rate to project developers in its queue, who choose whether or not to accept the rate.

Winding Creek, a one megawatt facility in California, filed a complaint in federal district court alleging that ReMAT is inconsistent with PURPA and is preempted by the Federal Power Act. The court dismissed the complaint twice for lack of standing but has allowed Winding Creek to amend the complaint and refile. In its second amended complaint, filed in June 2014, Winding Creek alleges that ReMAT is preempted because its rate is not based on an avoided cost determination, and because it caps the total capacity of all qualifying facilities that can participate. According to the complaint, while California continues to offer a short-run avoided
cost rate to qualifying facilities the state’s long-run avoided cost rate has been displaced by ReMAT. In its response, the CPUC argues that PURPA does not require a state to offer a long-term avoided cost rate. The CPUC also argues that Winding Creek still lacks standing.

Although neither state’s FiT has been overturned by a court, these two cases illustrate that FiTs are vulnerable to legal challenges. Although it may be difficult for the California developer seeking a higher rate to establish standing (see page 21 for further explanation), it is plausible that a utility, dissatisfied with the FiT rate required by the state, would have standing to challenge a FiT. In such a case, there is little precedent to predict whether states may establish an avoided cost rate through market-based mechanisms.

Guaranteeing Generator Revenue

**Summary and Conclusions**
- New generators may be unwilling to risk relying on revenue from FERC-regulated energy and capacity markets to recover their costs.
- State policies that aim to dampen the volatility of market prices by guaranteeing revenues to generators can amount to wholesale ratemaking and be preempted by the FPA.

Map of FERC-Regulated Organized Markets

Source: ISO/RTO Council. In late 2014, some utilities in six Western states will participate in the California ISO’s real-time energy markets.

**Market Background:** Utilities that serve approximately half of U.S. electricity customers participate in auction markets regulated by FERC pursuant to its authority under the Federal Power Act (ERCOT oversees the intrastate transmission of electricity within Texas and is therefore not regulated by FERC). In these organized markets, generators submit offers to sell quantities of energy, and buyers, such as distribution utilities that sell electricity to ratepayers, submit offers to buy. The RTO/ISO computes the clearing price where supply
intersects with demand, and then accepts all buyers’ bids above the clearing price and all sellers’ offers below the clearing price.

A utility typically does not procure all of its energy from an organized market. It may also procure energy through bilateral contracts with generators and, depending on the state, may own its own power plants. In addition to energy, generators in some markets can also sell capacity bilaterally or through RTO/ISO-organized auctions. Capacity payments compensate plants for having the ability to generate energy. Utilities may have to demonstrate that they have paid for sufficient capacity to meet their peak demand.

A state-mandated rate that is different from the rate generated by a FERC-regulated auction or an incentive connected to a FERC-regulated auction price may be preempted because it “supplants the rate generated by the [federally regulated] auction with an alternative rate preferred by the state.”

Legal Challenge: Fourth Circuit Holds Maryland Scheme Is Preempted

A recent decision from the Fourth Circuit illustrates preemption of a state policy that guaranteed generator revenue for wholesale sales (this lawsuit was also discussed in the dormant Commerce Clause section on page 6). Generators in the PJM region challenged a Maryland Public Service Commission (PSC) order that required each of the state’s distribution utilities to enter into a contract for differences with a new natural gas fired generator. The contract rate was the difference between the PJM clearing price and a rate set by the developer and approved by the PSC. For each sale of energy it made in PJM, the developer would receive the PJM price as well as the difference between the PJM price and the contract rate.

After reviewing FERC’s regulation of PJM, the Fourth Circuit panel concluded that the federal scheme is “carefully calibrated,” “comprehensive,” and “quite sensitive to external tampering.” The panel determined that the PSC’s order was field preempted because the Maryland order “functionally sets the rate” that the developer receives for its sales in the PJM auction markets and thus “compromises the integrity of the federal scheme and intrudes on FERC’s jurisdiction.” The order was also conflict preempted because it “substitut[es] the state’s preferred incentive structure for that approved by FERC.”

The Third Circuit held that a nearly identical scheme in New Jersey was field preempted but declined to decide whether the law was also conflict preempted.

Workaround: Mandate purchases without setting a rate

As long as it is does not set a wholesale rate, a state can require utilities to procure energy and capacity from new generation resources and may specify the type of resource. A state can
require a utility to issue an RFP for new generation or use other market-based mechanisms, such as reverse auctions, to procure a mandated amount of generation capacity. However, if the RFP is limited to in-state generators, it may violate the dormant Commerce Clause (see page 2).

**Legal Challenge: Developer Argues that State May Not Select RFP Winner**

A project developer has filed a lawsuit in federal district court arguing that a Connecticut RFP violates the Supremacy Clause. State law required regulators to conduct an RFP for new renewable generation and select the winning bids. According to the plaintiffs, by requiring the state’s distribution utilities to sign contracts with price terms that were offered by the bidders and selected by regulators, the state effectively set the wholesale rate of a contract and violated the federal requirement that contracts be freely negotiated.

**Setting the Price of Renewable Energy Credits**

**Summary and Conclusions**

- A Renewable Energy Credit (REC) is an instrument that certifies that a quantity of electricity was generated pursuant to certain standards. A renewable generator earns one REC for every unit of energy that it generates.
- RECs provide generators with revenue to supplement income from energy sales.
- According to FERC, a state policy that sets REC prices could be preempted.

In many states, utilities hold RECs to demonstrate compliance with the state’s RPS. For example, if an RPS requires a utility to source ten percent of its sales from renewable sources, state law may require each utility to demonstrate compliance by holding RECs equivalent to at least ten percent of its sales. RECs are typically sold through bilateral contracts or through auction markets that are not regulated by FERC.

RECs can be sold with their associated energy (bundled) or without any energy (unbundled). State laws differ on whether unbundled RECs can be used for compliance purposes. In 2012, FERC asserted that it has exclusive jurisdiction over bundled RECs (but not over unbundled RECs) because bundled RECs are sold “in connection with” and “affect” energy sales. However, this assertion has not been challenged in any federal court. In fact, in 2008, the Second Circuit determined that previous FERC orders did not “evince an intent to occupy the relevant field—namely, the regulation of renewable energy credits. Rather, [FERC] explicitly acknowledges that state law governs the conveyance of RECs.”
2. **Efficiency Standards and Building Codes**

Federal law explicitly preempts state efficiency standards for vehicles and many types of appliances, but generally allows states and local authorities to establish building codes. Voluntary programs for efficient vehicles may be permissible depending on the program’s scope.

**Vehicle Standards**

**Summary and Conclusions**

- The Energy Policy and Conservation Act (EPCA) established the Corporate Average Fuel Economy (CAFE) standards, which govern efficiency standards of new cars.
- Federal law prohibits a state or local government from adopting other fuel economy standards, but they may set requirements for their own fleets.
- A state or local government may offer limited incentives to promote fuel-efficient taxis.

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**Legal Challenge: Fuel Efficiency Rules for Taxis Are Preempted but Voluntary Programs and Limited Incentives Are Not**

In 2008, a federal district court barred New York City from implementing a miles-per-gallon standard for new taxis. According to the court, the city’s rule was likely preempted by federal law. The city did not appeal and instead issued a new rule that raised the maximum price a taxi owner can charge a driver to lease a hybrid or clean diesel taxi while lowering the cap for other vehicles. The effect of the new caps was to incentivize ownership of hybrid and clean diesel taxis. A district court prevented the rules from going into effect, concluding that the rules “constitute[d] an offer which cannot, in practical effect, be refused.”

The Second Circuit upheld the district court’s injunction, agreeing with the lower court that the city’s rules are “based expressly on the fuel economy of a leased vehicle, [and] plainly fall within the scope of the EPCA preemption provision.”

According to a district court in Washington State, while a “mandate” is preempted by the EPCA, a “voluntary incentive program” is not. King County issued an RFP for new taxi licenses and required winning applicants to use hybrid vehicles. The court distinguished the New York rules, which subjected all taxis to fuel efficiency requirements, from King County’s voluntary incentive program that affected only ten percent of taxis and did not require existing taxi owners to do anything. According to the court, only a mandate is preempted by EPCA.

Similarly, the Fifth Circuit upheld a Dallas ordinance that granted taxis running on compressed natural gas (CNG) queue-jumping privileges at the city’s airport. Plaintiffs argued that the ordinance was preempted by the Clean Air Act, which prohibits a state or local government from enacting “any standard relating to the control of emissions from new motor vehicles or new motor vehicle engines.” The Fifth Circuit panel concluded that the ordinance provides an
incentive and does not set a standard or “effectively compel” taxi owners to switch to CNG vehicles. The panel declined to “parse precisely when an incentive program might turn sufficiently coercive to qualify as a de facto standard,” leaving that question for future cases.

### Appliance Standards

#### Summary and Conclusions
- The Energy Policy and Conservation Act requires the Department of Energy (DOE) to set efficiency standards for more than a dozen types of appliances.
- A state efficiency standard for these appliances is preempted unless the state receives a waiver from DOE.
- A state may include efficiency standards in its own procurement guidelines.

The EPCA directs DOE to set efficiency standards for specific types of appliances, such as dishwashers and air conditioners, and authorizes the Department to set standards for other products that consume more than 100 kilowatt-hours per year in U.S. households. As of August 2014, DOE either had set or was scheduled to establish standards for approximately fifty appliance categories. To set its own standard in one of those categories, a state must establish that a waiver is necessary to meet an “unusual and compelling” energy or water interest. As of 2009, DOE had never granted a waiver. A state may set an efficiency standard for appliances not covered by a federal standard.

### Building Codes

#### Summary and Conclusions
- Federal law explicitly provides that state or local building codes are not preempted by federal law if those codes meet several conditions.
- One condition is that a building code may not require installation of an appliance that exceeds federal efficiency standards.

Industry groups argued that Washington State’s building code was preempted because the code’s alternatives to installing more efficient appliances were so costly that builders were economically coerced to select the high efficiency appliances. In 2012, the Ninth Circuit held that Washington’s economic incentive to install an appliance that exceeds federal standards is not a requirement. According to the panel, “the fact that certain options may end up being less costly to builders than others does not mean the state is, expressly or effectively, requiring those options.” The panel also concluded that a building code may not include a penalty for failing to install high efficiency appliances.
3. Regulation of Air Pollution

**Summary and Conclusions**

- States may set more stringent air pollution standards for stationary sources.
- Off-the-grid or backup generators are considered stationary sources, provided that they remain in place for at least twelve months.
- Although states are generally prohibited from regulating fuel for cars, the Ninth Circuit held that California’s Low Carbon Fuel Standard is not preempted.

The Clean Air Act explicitly grants states the authority to set more stringent air pollution standards for stationary sources, and case law seems clear on this. The legal questions raised in this area relate to whether a source is stationary. For instance, a challenge to California rules setting emission standards for certain generators turned on whether those generators were “new nonroad engines” used for farm equipment. The Ninth Circuit noted that the Clean Air Act authorized state regulation of stationary generators, which EPA defines as engines that remain in one place for at least twelve consecutive months. California regulations only reached sources and so were permissible. States can generally regulate air emissions from back-up generators, therefore, if the rules likewise focus on generators that remain in place for at least twelve consecutive months.

The more difficult questions arise in the regulation of pollution from mobile sources. California’s Low Carbon Fuel Standard (LCFS), which set carbon intensity targets for transportation fuels sold in the state, was challenged on CAA preemption grounds (and on dormant Commerce Clause grounds; see page 10).

The Clean Air Act prohibits a state from adopting any “control or prohibition respecting any characteristic or component of a fuel or fuel additive in a motor vehicle” but provides a waiver for California. California argued that this Section 211(c) waiver protected the LCFS from preemption and dormant Commerce Clause challenges; the challengers argued that the waiver did not apply because much of the carbon intensity value assigned to motor fuels related to the manufacture and transport of the fuel rather than a “characteristic or component” of the fuel. The district court held the LCFS properly fell within the 211(c) waiver but that the rule could be preempted by another provision of the Clean Air Act, the Renewable Fuel Standard. However, the court declined to rule on the preemption challenge, citing a need for additional briefing. The appeal focused on the Commerce Clause issues, and the Ninth Circuit “express[ed] no opinion” on the preemption issues. Preemption by the Clean Air Act’s Renewable Fuel Standard remains an open question.
Standing: Grounds for Dismissal

Standing is the ability of a party participate in a legal action. In response to recently filed lawsuits, states typically file motions to dismiss that argue that the challenger lacks standing. In general, a party cannot bring a legal action simply because of dissatisfaction with government policy. According to the Supreme Court, to bring an action in federal court a party must demonstrate that:

1. It has suffered an “injury in fact,” defined as an invasion of a legally-protected interest which is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical.
2. There is a causal connection between the injury and the conduct complained of; the injury is traceable to the challenged action of the defendant, and not the result of the independent action of some third party not before the court.
3. It is likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision by the court.¹

Even if a party can demonstrate those three elements necessary for Constitutional standing, the Supreme Court has determined that “a plaintiff may still lack standing under the prudential principles by which the judiciary seeks to avoid决定ing questions of broad social import where no individual rights would be vindicated and to limit access to the federal courts to those litigants best suited to assert a particular claim.”² To demonstrate prudential standing, a party must be asserting his own legal interests rather than the interests of a third party.

In some cases, a challenger may also need standing under a particular statute. For example, PURPA provides a private enforcement mechanism through which “[a]ny electric utility, qualifying cogenerator, or qualifying small power producer” may petition FERC to enforce implementation of the statute.³ If FERC does not initiate an action, the petitioner may file suit in a federal district court. In response to a recently filed lawsuit about a California feed-in tariff (see Page 14), the state has argued for dismissal, in part because it claims that the challenger lacks standing under PURPA.

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Legal Appendix — Overview of Constitutional Doctrines

The Commerce Clause and Supremacy Clause of the Constitution impose limits on state power. This Appendix provides an introduction to these Clauses, and includes examples of how federal courts have applied them to states’ energy laws. The Appendix also includes overviews of four statutes as they are relevant to recent Supremacy Clause challenges to state energy policies: the Federal Power Act, Public Utilities Regulatory Policies Act (PURPA), the Clean Air Act, and the Energy Policy and Conservation Act.

A. Dormant Commerce Clause

The Commerce Clause of the Constitution (Article I, § 8) authorizes Congress “to regulate commerce with foreign nations, and among the several states, and with the Indian tribes.” While the Commerce Clause focuses on what Congress can do, courts have inferred in the provision a limit on state power to regulate interstate commerce. The judicial doctrine is known as the “dormant Commerce Clause.”

The “fundamental objective” of the dormant Commerce Clause is to “preserv[e] a national market for competition undisturbed by preferential advantages conferred by a state upon its residents.”

1 States retain considerable authority to regulate matters affecting local concerns, but courts have invoked the dormant Commerce Clause to strike state laws that:

1) discriminate against out-of-state economic interests;
2) regulate commerce that takes place wholly outside of its borders; or
3) unduly burden interstate commerce.

1 General Motors Corp. v. Tracy, 519 U.S. 278, 299 (1986) (finding tax exemptions for local natural gas distribution companies did not violate the dormant Commerce Clause because the local distribution networks serving residential households did not compete with interstate pipelines serving bulk buyers); see also Baldwin v. G. A. F. Seelig, Inc., 294 U.S. 511, 522 (1935)) (“[i]f [one state], in order to promote the economic welfare of her [own industries], may guard them against competition with [out-of-state competitors], the door has been opened to rivalries and reprisals that were meant to be averted by subjecting commerce between the states to the power of the nation.”) (finding New York law requiring minimum wholesale pricing for milk resold in New York retail markets violated the dormant Commerce Clause because it set prices for out-of-state transactions); Hughes v. Oklahoma, 441 U.S. 322, 325–26 (1979) (noting the Framers’ concern about economic balkanization and finding that an Oklahoma law banning the export of minnows discriminated against interstate commerce on its face).

2 Kassel v. Consol. Freightways Corp., 450 U.S. 662, 670 (1981) (a “State’s power to regulate commerce is never greater than in matters traditionally of local concern”) (striking an Iowa law that prohibited 65-foot double trailer trucks within its borders as impermissibly burdening interstate commerce); see also See Southern Pac. Co. v. Arizona, 325 U. S. 761, 771 (1945) (finding “[t]here has thus been left to the states wide scope for the regulation of matters of local state concern, even though it in some measure affects the commerce, provided it does not materially restrict the free flow of commerce across state lines, or interfere with it in matters with respect to which uniformity of regulation is of predominant national concern.”) (striking an Arizona law limiting the number of cars that can be attached to a passenger or freight train).
If a state law trips the first or second test, courts will typically strike down the law as an unconstitutional assertion of state authority unless Congress has approved the state law, or the state is acting as a “market participant” rather than a regulator. The third test is a fact-based inquiry. Courts weigh whether a law’s burdens on interstate commerce are “clearly excessive” relative to its local benefits.

Across all three tests, the dormant Commerce Clause “protects the interstate market, not particular interstate firms, from prohibitive” state regulation. Therefore, the fact that the burden of a state regulation falls on only some interstate firms or impedes particular methods of operation does not, by itself, establish a claim under the dormant Commerce Clause.

1. State Laws that Discriminate against Out-of-State Interests
“In all but the narrowest circumstances,” courts will strike down a state law if it mandates differential treatment of in-state and out-of-state competing economic interests in a way that benefits the former and burdens the latter. The classic example of such a law is a protective tariff, which taxes goods imported from other states but does not tax similar goods produced in state. However, state laws can be discriminatory without being as explicitly protectionist as a tariff. Courts also find unconstitutional economic protectionism on the basis of a discriminatory purpose or effect. For example, courts will typically strike down a law that is intended to

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3 See Northeast Bancorp v. Bd. of Governors, 472 U.S. 159, 174 (1985) (stating that “[w]hen Congress so chooses, state actions which it plainly authorizes are invulnerable to constitutional attack under the Commerce Clause”). The federal Bank Holding Company Act permitted interstate transactions only when authorized by State law. Massachusetts and Connecticut that allowed an out-of-state bank holding company with its headquarters in another New England state to acquire an in-state bank. The Court held that in this case “the commerce power of Congress is not dormant” because it had authorized the type of laws passed by Massachusetts and Connecticut.

4 See, infra, at page 26.

5 Exxon Corp. v. Governor of Maryland, 437 U.S. 117, 127 (1978) (citing Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976). In Exxon, Maryland law prohibited oil producers and refiners from owning retail gas stations in the state, because they had been servicing their stations at the expense of others during periods of fuel shortage. The Supreme Court upheld Maryland’s law against dormant Commerce Clause and preemption challenges.

6 Id. at 126–27; see also Baude v. Heath, 538 F.3d 608, 615 (7th Cir. 2008) (noting that “[f]avoritism for large wineries over small wineries does not pose a constitutional problem . . .”) (striking a provision in Indiana law requiring small vintners to sell into Indiana through a wholesaler, but upholding a requirements for an initial face-to-face meeting with retail purchasers to verify their age, both under the Pike balancing test).


protect local economic interests from outside competition, or that has the effect of erecting economic barriers against interstate competition.

Courts subject state laws that discriminate against interstate commerce to strict scrutiny. This exacting standard requires a state to demonstrate both that the law has a non-protectionist purpose and that there is no less discriminatory means for achieving that purpose. Shielding in-state businesses from competition is “almost never a legitimate local purpose.” However, quarantine laws may survive; for instance, the Supreme Court determined that Maine’s ban on imports of live baitfish served the legitimate purpose of protecting the native ecology, and that there was no less discriminatory means for achieving that purpose.

On the grounds of discrimination, the Supreme Court has struck down an Oklahoma law requiring ten percent of electric utilities’ coal purchases to be from in-state suppliers, an Ohio law offering a tax credit for selling ethanol produced in Ohio, and a New Hampshire utility commission order prohibiting a utility from exporting hydropower generated in New Hampshire to another state. The Seventh Circuit struck down Illinois and Indiana laws that effectively required generators to install pollution controls so they could continue to use in-state coal rather than purchase out-of-state low-sulfur coal to comply with sulfur dioxide limits.

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10 Lewis v. BT Inv. Managers, Inc., 447 U.S. 27, 44 (1980) (striking Florida laws prohibiting out-of-state bank holding companies to own or control banks, investment advising firms, or trust service providers in Florida, as discriminating against interstate commerce).
12 The Court has also referred to the test as “rigorous scrutiny” (C & A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383, 392 (1994); United Haulers Assn., Inc. v. Oneida-Herkimer Solid Waste Management Auth., 550 U.S. 330, 343 (2007)) and “more demanding scrutiny” (Maine v. Taylor, 477 U.S. 131, 138 (1986)).
19 Alliance for Clean Coal v. Miller, 44 F.3d 591, 595 (7th Cir.1995); Alliance for Clean Coal v. Bayh, 72 F.3d 556, 560. (7th Cir. 1995). As noted on page 6, the clear intent of the law was to benefit in-state coal at the expense of western coal.
State tax policy must also navigate the constraints of the dormant Commerce Clause. Courts typically apply the generally applicable discrimination rules to state taxes and fees. The Supreme Court has held that “states may not impose taxes that facially discriminate against interstate business and offer commercial advantage to local enterprises, that improperly apportion state assessments on transactions with out-of-state components, . . . or that have the ‘inevitable effect [of] threaten[ing] the free movement of commerce by placing a financial barrier around the state.’” It is no defense that a law levies a discriminatory tax on intrastate commerce as well. However, a state tax on interstate activity may be appropriate if that tax or an equivalent “compensating tax” is applied to in-state commerce.

The Supreme Court has not directly addressed a Commerce Clause challenge to subsidies; however, in passing it has distinguished “[d]irect subsidization of domestic industry” from “discriminatory taxes” in a way that appears to condone subsidies:

> [t]he 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 ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does.

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20 See Walter Hellerstein and Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*. 81 CORNELL L. REV. 789 1995–1996 (discussing four cases that found State tax incentives violated the dormant Commerce Clause: Boston Stock Exchange v. State Tax Comm’n, 429 U.S. 318 (1977); Bacchus Imports Ltd. v. Dias, 468 U.S. 263 (1984); Westinghouse Elec. Corp. v. Tully, 466 U.S. 388 (1984); and New Energy Co. of Indiana v. Limbach, 486 U.S. 269 (1988)). In addition to not being discriminatory, a valid state tax of interstate activity is one that: has a substantial nexus with the state; is fairly apportioned; and is fairly related to the services provided by the State. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (upholding Mississippi’s sales tax on in-state sales as a permissible cost of doing business). The Supreme Court has noted that the “fair apportionment” prong may be viewed as a subset of the discrimination inquiry. (“A tax that unfairly apportions income from other States is a form of discrimination against interstate commerce.”) Armco v. Hardesty, 467 U.S. 638 (1984) (striking Virginia’s gross receipts tax, levied only on out-of-state businesses).


23 In re Appeals of CIG Field Servs. Co., 112 P.3d 138 (Kan. 2005) (finding property tax statute’s differentiation between interstate and intercounty natural gas gathering systems and intracounty systems violated the dormant Commerce Clause).


25 New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 278 (1988)).

26 Id.; see also Boston Stock Exchange v. State Tax Comm’n, 429 U.S. 318, 336–37 (1977); Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine, 520 U.S. 564, 591–92 (1997) (“[t]his distinction is supported by scholarly commentary as well as precedent, and we see no reason to depart from it”).
The Court has also noted that “[a] pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business.” However, subsidies funded by a tax on out-of-state competitors, or tax exemptions that are withheld from an in-state entity serving out-of-state interests or made conditional on the purchase of in-state products and the hiring of in-state workers, are problematic because each acts to “handicap[] out-of-state competitors.” The Sixth Circuit’s decision about an Ohio tax incentive package to Daimler-Chrysler illustrates a difference between types of tax incentives. The Court struck down the investment tax credit, awarded to businesses in Ohio that expand in the state rather than in other parts of the U.S., on the grounds that it discriminated against interstate commerce, but upheld the property tax exemption as a subsidy that properly incentivizes the productive use of local property. Scholars debate the existence of a true distinction between taxes and subsidies but it appears to survive in Supreme Court jurisprudence.

Finally, “any notion of discrimination . . . assumes a comparison of substantially similar entities.” If businesses provide different products, serve different markets, or have other relevant differences, the dormant Commerce Clause may not apply. For example, the Supreme Court has allowed differential tax treatment for sales by in-state public utilities and interstate natural gas marketers because they sold different products in different markets.

**Market Participant Exception**
The Supreme Court has held that “nothing 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.” In other words, where it is acting as a “purchaser, seller, or producer”

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28 Id.
29 Camps Newfound/Owatonna, 520 U.S. 564.
30 Pelican Chapter v. Edwards, 128 F.3d 910 (5th Cir. 1997).
31 Cuno v. DaimlerChrysler Corp., 386 F.3d 738 (6th Cir. 2004). The Supreme Court found that the plaintiffs had no standing to challenge the tax incentive package and did not reach the merits of the case. DaimlerChrysler Corp. v. Cuno, 547 U.S. 332 (2006).
33 General Motors Corp. v. Tracy, 519 U.S. 278, 298 (1997).
34 Id. at 298–305 (finding that public utilities generally provide gas “bundled with service and [consumer] protections” to a “market [not] susceptible to competition by the interstate sellers,” while interstate marketers sell “unbundled” gas to a “non-captive” market).
36 Atlantic Coast Demolition & Recycling, Inc. v. Bd. of Chosen Freeholders of Atlantic County, 48 F.3d 701 (3d Cir. 1995) (rejecting New Jersey’s contention that it was acting as a market participant when it required private market participants to bring waste to designated facilities).
of products and services, a state may patronize or prefer in-state businesses. For instance, the Supreme Court has upheld a Maryland abandoned car bounty program that required more documentation from out-of-state scrap processors;\textsuperscript{37} a South Dakota state-owned cement plant policy that prioritized sales to in-state purchasers;\textsuperscript{38} and a local hiring requirement for city-financed construction projects in Boston.\textsuperscript{39}

In a closely related line of cases, the Supreme Court has also allowed traditional government functions to evade Commerce Clause scrutiny. Therefore, while the Supreme Court has overturned local rules requiring solid waste to be deposited at a particular privately owned transfer station,\textsuperscript{40} the Court allowed New York to require waste haulers to deliver to an in-state public waste processing plant.\textsuperscript{41} The Court also applied this reasoning to find that Kentucky could tax interest on out-of-state public bonds while exempting interest on in-state public bonds.\textsuperscript{42} The Court observed that state and local governments are “vested with the responsibility of protecting the health, safety, and welfare of [their] citizens.”\textsuperscript{43} Therefore, laws favoring publicly provided goods and services are not prohibited by the dormant Commerce Clause, so long as they are “directed toward any number of legitimate goals unrelated to protectionism.”\textsuperscript{44}

However, reading the market participant exception too broadly would run the risk of “swallowing up the rule” to prohibit discrimination against interstate commerce. Therefore, even as a broker of goods, “[t]he state may not impose conditions . . . that have a substantial regulatory effect outside of that particular market.” The Court therefore rejected Alaska’s contention that as a “market participant” in the raw timber market, the state could restrict downstream processing (a different market) to in-state companies.\textsuperscript{45}

Moreover, courts will not apply the exemption where a state appears to be wielding regulatory power.\textsuperscript{46} As the Third Circuit has explained:

\begin{itemize}
\item\textsuperscript{37} Hughes, 426 U.S. 794.
\item\textsuperscript{38} Reeves, Inc. v. Stake, 447 U.S. 429 (1980).
\item\textsuperscript{39} White v. Massachusetts Council of Construction Employees, Inc., 460 U.S. 204 (1983).
\item\textsuperscript{40} C & A Carbone, Inc. v. Clarkstown, 511 U.S. 383 (1994).
\item\textsuperscript{41} United Haulers Ass’n, Inc., v. Oneida-Herkimer Solid Waste Management Auth., 550 U.S. 330 (2007).
\item\textsuperscript{42} Dep’t of Revenue of Kentucky v. Davis, 553 U.S. 328 (2008).
\item\textsuperscript{43} \textit{Id.} at 340 (citing United Haulers, 550 U.S. at 342).
\item\textsuperscript{44} \textit{Id}.
\item\textsuperscript{45} South-Central Timber Development, Inc. v. Wunnicke, 467 U.S. 83, 97 (1984).
\item\textsuperscript{46} See New Energy Co. v. Limbach, 486 U.S. 269, 277 (1986) (stating that the market participant doctrine “differentiates between a State’s acting in its distinctive governmental capacity [as a regulator] and a State’s acting in the more general capacity of a market participant; only the former is subject to the limitations of the negative Commerce Clause.”).
\end{itemize}
When a public entity participates in a market, it may sell and buy what it chooses, to or from whom it chooses, on terms of its choice; its market participation does not, however, confer upon it the right to use its regulatory authority to control the actions of others in that market. 47

On this reasoning, the Third Circuit struck down a Delaware prevailing wage law that differentiated between in-state and out-of-state apprenticeship certifications, because the law extended beyond a specific contract or project to set state-wide policy, and set penalties for employers that did not follow the payment tiers. 48 Likewise, the Supreme Court refused to extend the market participant exception to Los Angeles when it set requirements for trucks entering its port. The city was setting air pollution policy, under the threat of criminal penalties for violators, rather than acting to protect a narrow proprietary interest. 49

2. State Laws that Regulate Extraterritorially

Courts will typically strike down a state law that regulates commerce occurring wholly outside the boundaries of the state. The inquiry turns on whether the statute directly controls conduct in another state, 50 which could subject that conduct to inconsistent rules. 51

The Supreme Court has rarely invoked extraterritoriality to strike down a state law. 52 In 1935, the Supreme Court ruled that “New York has no power to project its legislation into Vermont by regulating the price to be paid in that state for milk acquired there.” 53 The Court echoed this prohibition decades later to void state laws that regulated alcohol prices in other states. 54 Subsequently, the Court extended the prohibition beyond price control laws, striking down a

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47 Atlantic Coast Demolition, 48 F.3d 701, 717.
49 Amer. Trucking Ass’ns, Inc. v. City of Los Angeles, 133 S. Ct. 2096, 2102–04 (2013). The constitutional issue in this case was preemption rather than dormant Commerce Clause; but the case turned on the language of a federal statute which preempted state provision “having the force and effect of law related to a price, route, or service of any motor carrier.” 49 U.S.C. § 14501(c)(1). The Court handled the inquiry as it would an analysis of a market participant defense. Amer. Trucking Ass’ns, Inc., 133 S. Ct. 2096.
52 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.”); see also American Beverage Ass’n v Snyder, 735 F.3d 362 (6th Cir. 2013) (Sutton, J., concurring) (“I am not aware of a single Supreme Court dormant Commerce Clause holding that relied exclusively on the extraterritoriality doctrine to invalidate a state law.”).
New York town’s waste flow rules because “states and localities may not attach restrictions to exports or imports in order to control commerce in other states.”

Although the Supreme Court has rarely invoked extraterritoriality to strike down a state law, all but one federal Circuit has adopted a dormant Commerce Clause analysis that considers extraterritoriality. Extraterritorial cases turn on whether a state law “has the practical effect of controlling commerce that occurs entirely outside of the state.”

A pair of cases from the Sixth Circuit illustrates the possible contours of this doctrine. In 2010, the court upheld an Ohio rule setting minimum requirements for hormone-free labeling claims on dairy products sold in that state. The court found that the labeling requirements did not dictate to out-of-state producers how to label their products outside of Ohio; therefore, it did not “impede or control the flow of milk products across the country.” More recently the court voided a Michigan law requiring a “unique-to-Michigan” label on returnable bottles and cans sold in that state. Michigan had wanted to prevent people seeking to benefit from Michigan’s generous deposit law from importing bottles and cans. The court found that Michigan’s law “not only requires beverage companies to package a product unique to Michigan but also allows Michigan to dictate where the resulting product can be sold.” The two cases can be read to mean that a state may require product labeling generally, but may not require a geographically explicit label and tie that label to a limitation on the seller’s market. Requiring an out-of-state seller to use geographically explicit labels that restrict sales to a single state amounts to control of commerce occurring entirely outside of the state.

3. State Laws that Unduly Burden Interstate Commerce

A law that is not discriminatory, does not regulate extraterritorially, and is “directed to legitimate local concerns” will “frequently survive” dormant Commerce Clause scrutiny notwithstanding any “incidental” effects on interstate commerce. However, a court may

56 Int’l Dairy Foods Ass’n v. Boggs, 622 F.3d 628, 645–646 (6th Cir. 2010) (citing cases from all Circuits but the 5th).
57 Int’l Dairy Foods Ass’n, 622 F.3d at 645 (citing Healy v. Beer Institute, 491 U.S. 324, 336 (1989)).
58 Id. Part of the rule was struck, but on other grounds.
59 Id. at 647.
60 American Beverage Ass’n v Snyder, 735 F.3d 362 (6th Cir. 2013).
61 American Beverage Ass’n, 735 F.3d at 376. The concurrence in this case took issue with the whole concept of extra-territoriality as a basis for voiding a state law, given the interstate nature of the U.S. economy and the difficulty courts may have in determining whether a law merely affects or actually controls out-of-state activity.
strike down such a law if it finds that “the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits.”\textsuperscript{64} The Court established this test in \textit{Pike v. Church}, which struck down an Arizona law that required in-state processing of cantaloupes grown in Arizona. In that case, a company that shipped its fruit out of state for processing alleged that the state law would require the company to invest in new processing facilities. The Court determined that the burden on the company outweighed the purported benefit of the Arizona law, which was to enhance the reputation of Arizona growers.

When evaluating the burden on interstate commerce, courts will consider “the nature of the local interest involved, and . . . whether it could be promoted as well with a lesser impact on interstate activities.”\textsuperscript{65} The Supreme Court has observed that a “nondiscriminatory regulation serving substantial state purposes is not invalid simply because it causes some business to shift from a predominantly out-of-state industry to a predominantly in-state industry.”\textsuperscript{66}

Applying the \textit{Pike} analysis, the Supreme Court upheld an Arkansas Public Service Commission order asserting jurisdiction over wholesale rates charged by an electric cooperative to its members.\textsuperscript{67} The Court determined that while the state’s regulation of prices paid by cooperatives may have some effects on interstate prices, state regulation of retail utilities can likewise affect prices. Any incidental effect did not outweigh the state’s interest in regulating prices that would ultimately be paid by in-state ratepayers.\textsuperscript{68} The Supreme Court also upheld a Kansas Corporation Commission order about in-state gas production that had the effect of increasing in-state producers’ sales at the expense of out-of-state producers.\textsuperscript{69} According to the Court, the effects on interstate markets were not “‘clearly excessive’ in relation to Kansas’ substantial interest in controlling production to prevent waste and protect correlative rights.”

Recently, the Supreme Court has expressed reservations about the judiciary’s ability to engage in the fact-based inquiry required under \textit{Pike}. For instance, in the Kentucky decision upholding tax preferences for income from state municipal bonds, the Court said that “the current record

\textsuperscript{64} Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).
\textsuperscript{65} Id. The test is similar to strict scrutiny, which requires a State to demonstrate both that the law has a non-protectionist purpose and that there is no less discriminatory means for achieving that purpose. However, \textit{Pike} is more deferential to the state.
\textsuperscript{66} Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 474 (1981) (upholding Minnesota’s ban on the retail sale of milk in plastic non-returnable containers because the environmental benefits outweighed any burden on interstate commerce).
\textsuperscript{68} Arkansas’ regulation of wholesale rates was not preempted by the Federal Power Act because the Act does not provide FERC with jurisdiction over rates charged by cooperatives.
and scholarly material convince us that the Judicial Branch is not institutionally suited to draw reliable conclusions of the kind that would be necessary . . . to satisfy a Pike burden in this particular case."  

A year earlier, the Court warned that it would not “rigorously scrutinize economic legislation passed under the auspices of the police power” for the purpose of judging the wisdom of such legislation. In separate concurrences to that decision, Justice Scalia rejected the Pike test outright, while Justice Thomas reiterated his long-standing position that the dormant Commerce Clause “has no basis in the Constitution and has proved unworkable in practice.”

The Pike test, however, remains valid, and courts continue to apply it to evaluate nondiscriminatory state laws.

**B. Supremacy Clause**

The Constitution’s Supremacy Clause, Article VI, § 2, empowers Federal legislative action to preempt or supersede state law. Congress can preempt state action expressly, or by implication, such as when a federal law occupies the same field as or conflicts with state law.

To determine whether a state law is preempted, courts first “focus on the plain wording of the [federal law], which necessarily contains the best evidence of Congress’ pre-emptive intent.” If the federal law expressly preempts state action, the state law cannot stand. If there is no express preemption, courts must determine if there is implicit preemption. If a state is acting on its “historic police power” or in an area “traditionally occupied” by the states courts start with a presumption against preemption. In general, traditional police powers involve matters relating to public health and safety, which the Supreme Court has indicated extends to utility regulation. In a case reviewing a state public utility commission’s oversight of cooperative

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70 Dep’t of Revenue of Ky. v. Davis, 553 U.S. 328, 353 (2008); see also Colon Health Ctr. of America LLC v. Hazel, 733 F.3d 535 (4th Cir. 2013) (“The Pike test is often too soggy to properly cabin the judicial inquiry or effectively prevent the district court from assuming a super-legislative role,” citing Dep’t of Revenue v. Davis).

71 United Haulers Ass’n v. Oneida-Herkimer Solid Waste Management Auth., 550 U.S. 330, 346 (2007).


75 New State Ice Co. v. Liebmann, 285 U.S. 262, 304 (1932) (“It is settled that the police power commonly invoked in aid of health, safety, and morals extends equally to the promotion of the public welfare.”)
electric utilities, the Supreme Court said that “the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the states.”

When the presumption against preemption applies, courts can overcome the presumption by finding that the state law is “field” preempted or “conflict” preempted by Federal law. No such presumption exists if a state is regulating in an area “where there has been a history of significant federal presence.”

Field Preemption

“States are precluded from regulating conduct in a field that Congress . . . has determined must be regulated by its exclusive governance.” Courts can glean Congress’s intent to occupy a given field of regulation from a law’s “structure and purpose;” for instance, where a scheme of federal regulation is “so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it.” Similarly, courts can infer field preemption if Congress’s act relates to a field where the “Federal interest is so dominant that the Federal system can be assumed to preclude enforcement of state laws on the same subject.”

The Supreme Court recently explained that “[f]ield preemption reflects a congressional decision to foreclose any state regulation in the area, even if it is parallel to federal standards.”

Conflict Preemption

Courts can also find preemption when there is a conflict between a state law and a Federal statute or regulation. Courts find conflict preemption when a state law “stands as an obstacle to the accomplishment and execution of the [Congress’] full purposes and objectives.” For example, the Supreme Court held that an Arizona law that made it a misdemeanor for “an authorized alien to knowingly apply for work” was in conflict with federal immigration law

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81 Id.


83 Hines v. Davidowitz, 312 U.S. 52, 66–68 (1941) (voiding a Pennsylvania law requiring registration of certain aliens because it conflicted with the federal Alien Registration Act).
because “Congress made a deliberate choice not to impose criminal penalties.” The Court determined that Arizona’s conflicting method of enforcement “would interfere with the careful balance struck by Congress with respect to unauthorized employment of aliens.”

A state law is also preempted if it is impossible for a party to comply with both state and federal law. When a Court determines that there is a conflict, the relative importance of the state’s interest is immaterial; state law must always yield to federal interests.

**Market Participant Exception**

When a state government acts as a market participant, and not a regulator, its actions may not be subject to preemption (the Supreme Court has articulated a market participant exception to the dormant Commerce Clause as well; see page 26). For example, the Supreme Court held that the National Labor Relations Act did not preempt a state construction contract that included terms about labor issues because the state was acting “as proprietor and its acts therefore are not ‘tantamount to regulation’ or policymaking.”

On the other hand, a state may not use its purchasing power to achieve regulatory goals. The Supreme Court struck down a Wisconsin statute that barred the state from contracting with a firm that had been repeatedly sanctioned by the National Labor Relations Board. The Court found that the Wisconsin law “functions unambiguously as a supplemental sanction for violations” of federal law, and therefore “conflicts with the [National Labor Relations] Board's comprehensive regulation of industrial relations.”

**1. Federal Statutes that May Preempt State Energy Law**

The Federal laws that have been implicated in recent preemption challenges to state energy policies are the Federal Power Act, the Public Utility Regulatory Policies Act (PURPA), the Clean Air Act, and the Energy Policy and Conservation Act. The portions of each statute that are relevant to recent preemption challenges are summarized below.

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85 Id.
86 Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-143 (1963) (upholding a California law setting maturity standards for avocados that was different than standards set under the federal Agricultural Adjustment Act, because the differences did not give rise to a conflict).
The Federal Power Act

The Federal Power Act (FPA) provides authority to the Federal Energy Regulatory Commission (FERC) and preserves states’ historic regulatory roles. In the FPA, Congress declared that generally FERC’s jurisdiction “extend[s] only to those matters which are not subject to regulation by the states.”

One of Congress’s reasons for entering the field of electricity rate regulation was to close the “gap” identified by the Supreme Court in Attleboro. In that case, the Court struck down a state utility commission’s order that set the wholesale rate of sale by a utility in Rhode Island to a utility in Massachusetts. That order imposed “a direct burden on interstate commerce” and was therefore beyond the authority of either state.

The Court concluded that only Congress has authority to close this “gap” and regulate interstate sales.

The Court more recently stated, in 2002, that while Attleboro “catalyzed the enactment of the FPA,” it is “perfectly clear that the original FPA did a good deal more than close the gap in state power.” To close the gap, Congress provided FERC with jurisdiction over the “sale of electric energy at wholesale in interstate commerce.” The FPA also grants FERC authority over “the transmission of electric energy in interstate commerce” and over “all facilities for such transmission or sale of electric energy.”

The statute reserves state jurisdiction over “any other sale of electric energy,” such as retail sales to end users, or over facilities used for generation, local distribution, or intrastate transmission.

While “Congress meant to draw a bright line easily ascertained between state and federal jurisdiction,” the “landscape of the electric industry has changed since the enactment of the FPA [in 1935].” Some changes have been technological; others are regulatory, such as the breakup of vertically integrated utilities by some states. As a result, the jurisdictional boundaries set by the FPA nearly eighty years ago can be difficult to apply.

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93 16 U.S.C. § 824(b)(1). The Supreme Court has held that FERC’s jurisdiction over the sale of power is specifically confined to the wholesale market. However, FERC’s jurisdiction over electricity transmissions includes all interstate transmission, regardless of whether it is wholesale or retail. New York, 535 U.S. at 20 (2002).
94 Id.
95 Id.
96 Fed. Power Comm’n v. S. Cal. Edison Co., 376 U.S. 205, 215 (1964); see also Conn. Light & Power Co. v. Fed. Power Comm’n, 324 U.S. 515, 531 (1945) (Congress was “plainly was trying to reconcile the claims of federal and of local authorities and to apportion federal and state jurisdiction over the industry.”).
97 New York, 535 U.S. at 17 (citing Transmission Access Policy Study Group v. FERC, 225 F.3d 667, 691 (D.C. Cir. 2000) (observing that the electric industry is no longer “neatly divided into spheres of retail versus wholesale sales.”)).
98 Id.
The Supreme Court has consistently held that FERC has “exclusive” authority to “regulate the transmission and sale at wholesale of electric energy in interstate commerce, without regard to the source of production.”99 FERC’s exclusive authority includes “the authority to determine the reasonableness of wholesale rates.”100 (As discussed on page 36, PURPA carves out a limited state role for regulation of wholesale rates.)

The FPA also grants FERC authority to “regulate practices affecting the wholesale market . . . provided that the Commission is not directly regulating a matter subject to state control, such as the retail market.”101 Whether this jurisdiction is exclusive to FERC is unclear. While states may not regulate in areas where FERC has exercised its jurisdiction over matters “affecting” wholesale rates,102 it is also true that state regulation, including resource planning and generation siting, “affects” wholesale markets and interstate transmission.103 Even if FERC’s “affecting” jurisdiction is exclusive, the scope of this jurisdiction cannot be so large as to nullify authority over retail rates and generation that the FPA reserves for states.104

Courts have found that FERC’s exclusive jurisdiction over wholesale sales can preempt state action. For example, the Supreme Court has consistently held that states may not reassess FERC-approved cost allocations between affiliated energy companies in the course of setting retail rates.105 The Third and Fourth Circuits have similarly held that a state may also not “supplant” rates generated by a FERC-approved wholesale market by requiring regulated utilities to enter into contracts for differences106 with a generator that are based on federally

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101 Electric Power Supply Association v. FERC WL 2142113 (D.C. Cir. 2014) (emphasis added) (citing 16 U.S.C. § 824(d)).
102 Miss. Power & Light, 487 U.S. at 374.
103 See PPL Energyplus LLC v. Solomon, 2014 WL 4454999 (3d Cir. 2014) (“Nor do we endorse the argument that LCAPP has been field preempted because it affects the market clearing price by increasing the supply of electric capacity . . . . Accordingly, we do not view LCAPP’s incidental effects on the interstate wholesale price of electric capacity as the basis of its preemption problem. Indeed, were we to determine otherwise, the states might be left with no authority whatsoever to regulate power plants because every conceivable regulation would have some effect on operating costs or available supply. That is not the law.”).
106 Under a contract for differences, the price paid is based on the difference between the current market price and a price set in the contract. In Maryland, if the PJM price was higher than a formula price approved by the PSC,
regulated auction prices.\textsuperscript{107} However, the Second Circuit ruled that in setting retail rates a state may “impute” revenue from a reasonable estimate of a regulated utility’s wholesale sales because that inclusion does not constitute regulation of wholesale rates.\textsuperscript{108}

Two D.C. Circuit court decisions published in 2014 illustrate that regional markets and planning continue to be the subject of jurisdictional disputes. Both cases were about the scope of FERC’s jurisdiction under the FPA, and not about whether a state law is preempted by the FPA. In one case, a divided panel held that the Commission may not regulate the price of demand response in wholesale energy markets.\textsuperscript{118} The Court reasoned that demand response payments in wholesale markets lure retail customers to reduce their consumption. FERC’s regulation therefore overstepped its boundaries under the Federal Power Act into a regulation of retail markets, which, according to the court, the Act reserves for the states. Three months later, the D.C. Circuit upheld FERC’s Order 1000, determining that FERC’s mandate for regional transmission planning does not interfere with state authority that is preserved under the FPA.\textsuperscript{119} In each case, a handful of states filed briefs. For demand response, states unanimously supported FERC’s assertion of jurisdiction. A different set of states unanimously opposed FERC over transmission planning.

**Public Utility Regulatory Policies Act (PURPA)**

PURPA, enacted by Congress in 1978, opened the generation market to non-utility-owned generators. The statute directed FERC to promulgate rules requiring utilities to offer to sell electricity to, and purchase electricity from, “qualifying cogeneration and small power production facilities.”\textsuperscript{109} A qualifying facility is either a renewable generator smaller than 80 megawatts or a co-generator that meets certain efficiency requirements.\textsuperscript{110} PURPA requires states to set prices at which each utility must purchase from qualifying facilities, while not allowing that price to “exceed . . . the cost to the electric utility of the electric energy which, but for the purchase from such [qualifying facility] such utility would generate or purchase from another source.”\textsuperscript{111}

PURPA thus expands previous state jurisdiction under the FPA by requiring limited wholesale ratemaking. However, state regulation of wholesale rates that strays outside the boundaries of

\textsuperscript{109} 16 U.S.C. § 824a—3. These provisions of PURPA are codified in the US Code as part of the Federal Power Act.
\textsuperscript{110} 18 C.F.R. §§ 292.203–205.
\textsuperscript{111} 16 U.S.C. § 824a—3(b), (d).
PURPA, either by regulating rates paid to generators that have not been certified by FERC as meeting the statute’s qualifications or by mandating rates that are higher than “incremental cost” (also known as avoided cost), can still be preempted by the FPA.

In 2010, FERC explained that it is “reluctant to second guess the state commission’s determinations”\(^{112}\) of avoided cost for capacity and energy. FERC decided that a state’s determination of avoided cost “may take into account obligations imposed by the state that, for example, utilities purchase energy from particular sources of energy or for a long duration.”\(^{113}\) FERC’s decision allows a state to set an avoided cost rate applicable only to sources eligible to meet a state’s renewable energy mandate.  

In 2005, Congress terminated the requirement that utilities purchase energy from PURPA generators in regions where there are competitive markets for wholesale energy.\(^{114}\) A utility can apply to FERC for this exemption from PURPA. FERC issues decisions on a case-by-case basis but has established a rebuttable presumption that utilities that are members of an RTO or ISO should be relieved of their obligation to purchase energy from qualifying facilities larger than 20 megawatts.\(^{115}\)

**Clean Air Act**

For centuries, court-made law enabled persons harmed by pollution to seek relief on grounds that the pollution was a “nuisance” or had wrongfully trespassed on the victims’ property. The Third Circuit has ruled that the Clean Air Act (CAA) does not preempt state common law claims for air pollution.\(^{116}\)

Meanwhile, Section 116 of the CAA explicitly authorizes states to set emission standards for stationary sources that are more stringent than the CAA requires.\(^{117}\) The CAA assigns states a large role in regulating pollution from stationary sources such as fossil-fuel fired power plants. In some cases, upon approval by EPA, states run the source permitting programs set forth

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\(^{112}\) California Public Utilities Commission, 133 FERC ¶ 61,059 at P 24 (2010).

\(^{113}\) Id. at P 26.

\(^{114}\) 16 U.S.C. § 824a—3(m).

\(^{115}\) 18 C.F.R. § 292.309; Public Service Co. of New Hampshire, 131 FERC ¶ 61,027 at P 18 (2010). Prior to PURPA’s enactment in 1978, non-utility generators would have had to negotiate with utilities to connect to the grid and sell power. Utilities would have been unlikely to welcome to the competition and generally could have refused to deal with new entrants into the market. By 2005, open access transmission and regional wholesale markets made it far easier for new entrants to connect and sell power. Congress therefore allowed utilities to petition for exemptions from PURPA, which would be granted if new entrants had sufficient access to the market.


\(^{117}\) 42 U.S.C. § 7416.
under the CAA. All states set source limits that will help the state achieve federal air quality and visibility targets.

However, the CAA prohibits state regulation of motor vehicle fuels, motor vehicles, non-road engines and vehicles, and aircraft. A string of challenges by taxi cab associations against city “clean fleet” rules suggest that states could encourage, but not require, taxi owners to drive low-emission vehicles and withstand a CAA preemption challenge (See page 18).

Meanwhile, at least one circuit has ruled that EPA’s CAA regulations do not define “nonroad engines” to include stationary generators, and so states may regulate air pollution from off-the-grid or backup generators.

**Energy Policy and Conservation Act**

The Energy Policy and Conservation Act (EPCA), passed in 1975, requires two federal agencies to establish efficiency standards. The Department of Transportation must establish average fuel economy standards for automobiles. These standards, known as CAFE standards, preempt any state or local standard “related to fuel economy standards or average fuel economy standards for automobiles.”

The EPCA also sets efficiency standards for a range of consumer products and requires the Department of Energy to amend the standards, if necessary. Those federal standards preempt state standards for those appliances, unless DOE grants the state a waiver.

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120 42 U.S.C. § 7491(b); 40 C.F.R. § 51.300 et seq.
121 42 U.S.C. § 7545(c)(4).
122 42 U.S.C. § 7543(a). Because California had a comprehensive air pollution statute before enactment of the CAA, federal law allows California to seek a waiver from the prohibition on state regulation of motor vehicles.
125 Compare Ass’n of Taxicab Operators USA v. City of Dallas, 720 F.3d 534 (5th Cir. 2013), with Metropolitan Taxicab Board of Trade v. City of New York, 2008 WL 4866021 (S.D.N.Y 2008), and Metropolitan Taxicab Board of Trade v. City of New York, 615 F.3d 152 (2d Cir. 2010).
126 Jensen Family Farms v. Monterey Bay Unified Air Pollution Control District, 644 F.3d 934, 942 (9th Cir. 2011) (citing 40 C.F.R. § 89.2).
130 42 U.S.C. § 6297(c).
Endnotes to Part I

4 Int’l Dairy Foods Ass’n v. Boggs, 622 F.3d 628, 645–46 (6th Cir. 2010) (citing cases from all Circuits but the 5th).
5 Pike, 397 U.S. at 142.
7 Database of State Incentives for Renewables and Efficiency, available at http://www.dsireusa.org/.
12 Colorado S.B. 13-252 (2013) [amending Colorado Rev. St. 40-2-124(a)(IX) (formerly VI); (c)(III), (VI); and (f)], available at: https://statepowerproject.files.wordpress.com/2014/03/sb13252_en.pdf.
13 But see Bacchus Imports Ltd., v. Dias, 468 U.S. 268 (1984) (holding that a tax exemption for brandy distilled from the root of an indigenous shrub and fruit wine manufactured in Hawaii violates the dormant Commerce Clause because it has both the purpose and effect of discriminating in favor of local products). Here, the Court relied heavily on language in the challenged statute, making it clear Hawaiian legislators intended to protect indigenous wine in the marketplace. As noted on page 6, a court may be more inclined to find discrimination when a law includes protectionist language.
14 MGL ch. 25A, § 11F; 225 CMR 14.00; 225 CMR 15.00; Class I includes new or newly expanded solar PV or thermal, wind, ocean thermal, wave, tidal, renewable fuel cells, landfill gas, certain biomass and hydro, and geothermal. MGL ch. 25A, § 11F(c).
16 MGL ch. 25A § 11F(g).
21 Atlantic Coast Demolition & Recycling, Inc. v. Bd. of Chosen Freeholders of Atlantic County, 48 F.3d 701 (3d Cir. 1995).

Id.


North Dakota v. Heydinger, Case No. 11-cv-3232 (D. Minn. 2014), at 43.

Id. at 44.


Id. at *14.


Rocky Mountain Farmers Union, 843 F. Supp.2d at 1078–79.

Id. at 1092.

Id. at 1092-93.

Rocky Mountain Farmers Union, 730 F.3d at 1103 (quoting Gravquick A/S v. Trimble Navigation Int’l Ltd., 323 F.3d 1219, 1224 (9th Cir. 2003)).

Rocky Mountain Farmers Union v. Corey, 730 F.3d at 1102–03.

Id. at 1105.

Id. at 1107.

The challengers sought a rehearing en banc and review by the Supreme Court; the motion for rehearing and petitions for cert were denied. Rocky Mountain Farmers Union v. Corey, 740 F.3d 507 (9th Cir. 2014), available at: http://statepowerproject.files.wordpress.com/2014/03/ninth-circuit-en-banc-denial-jan-22-2014.pdf; Rocky Mountain Farmers Union v. Corey, 134 S.Ct. 2875 (June 30, 2014); Amer. Fuel & Petrochemical Mfrs. Ass’n v. Corey, 134 S.Ct. 2875 (June 30, 2014); Corey v. Rocky Mountain Farmers Union, 134 S. Ct. 2884 (June 30, 2014).


Order on Rehearing, Clarification and Compliance, 149 FERC ¶ 61,058 at P 18 (2014).


Id.


Id.


Id. at P 32.

Id. at P 30.


See Niagara Mohawk Power Corp. v. FERC, 117 F.3d 1485, 1488 (D.C. Cir. 1997) (explaining that FERC’s order is “of no legal moment unless and until a district court adopts that interpretation when called upon to enforce PURPA”); see also Xcel Energy Servs., Inc. v. FERC, 407 F.3d 1242, 1244 (D.C. Cir. 2005) (“An order that does no
more than announce [FERC's] interpretation of the PURPA or one of the agency's implementing regulations is of no legal moment unless and until a district court adopts that interpretation when called upon to enforce the PURPA.

79 16 U.S.C. § 824a—3(m).
80 18 C.F.R. § 292.309; Public Service Co. of New Hampshire, 131 FERC ¶ 61,027 at P 18 (2010).
81 Id. at P 21.
82 Otter Creek Solar, 143 FERC ¶ 61,192 (2013); reh’g denied 146 FERC ¶ 61,192 (2014).
86 Id.
88 Allco Finance Ltd. v. Esty, Case No. cv-01874 (D. Conn. 2013).
89 WSP Inc., 139 FERC ¶ 61,061 (2012) (citing 16 U.S.C. §§ 824(d), (e)).
91 49 U.S.C. § 32919(a) (Energy Policy and Conservation Act); 42 U.S.C. § 7543 (Clean Air Act). The Clean Air Act allows California to apply for a waiver to adopt more stringent standards, but California agreed to the federal standard through 2025. A 2012 rule issued jointly by the Department of Transportation acting pursuant to its authority under EPCA and EPA acting pursuant to the Clean Air Act, set fuel efficiency standards through model year 2025. California’s parallel vehicle regulations allow compliance with the federal standards to meet the State’s standards. In their final rule, the federal agencies stated that they “fully expect that any adjustments to the standards will be made with the participation of CARB and in a manner that ensures continued harmonization of state and Federal vehicle standards.” 2017 and Later Model Year Light-Duty Vehicle Greenhouse Gas Emissions and Corporate Average Fuel Economy Standards; Final Rule. 77 Fed. Reg. 62624, 62784 (Oct. 15, 2012).
92 49 U.S.C. § 32919(c); see also Engine Mfrs. Ass’n v. South Coast Air Quality Management Dist., 498 F.3d 1031 (2007) (holding that fleet rules governing procurement decisions by State and local governments are not preempted by the Clean Air Act).
94 Metropolitan Taxicab Bd. of Trade v. City of New York, 615 F.3d 152, 158 (2nd Cir. 2010).
95 Metropolitan Taxicab Bd. of Trade v. City of New York, 2010 WL 2643369 (W.D. WA 2010).
96 Green Alliance Taxi Cab Association, Inc., et al. v. King County, 2010 WL 2643369 (W.D. WA 2010).
97 42 U.S.C. § 7543(a).
100 Metropolitan Taxicab Bd. of Trade v. City of New York, 615 F.3d 152, 158 (2nd Cir. 2010).
101 Green Alliance Taxi Cab Association, Inc., et al. v. King County, 2010 WL 2643369 (W.D. WA 2010).
102 42 U.S.C. § 7543(a).
104 42 U.S.C. § 6297(d).


Id. (citing Air Conditioning, Heating and Refrigeration Institute v. City of Albuquerque, 2008 WL 5586316 (D. N.M. 2008).

But see New York v. EPA, 413 F.3d 3, 42 (D.C. Cir. 2005) (noting states that alleged new federal Clean Air Act rule would not allow states to submit more stringent requirements for approval, and holding that the concern was not yet ripe).

40 C.F.R. § 89.2.

Jensen Family Farms v. Monterey Bay Unified Air Pollution Control District, 644 F.3d 934, 942 (9th Cir. 2011) (citing 40 C.F.R. § 89.2).


Id. at 1047.

Id. at 1103.

Rocky Mountain Farmers Union v. Corey, 730 F.3d 1070, 1107 (9th Cir. 2013).

Elec. Power Supply Ass’n v. FERC, 753 F.2d 216 (D.C. Cir. 2014).