Extraterritorial Ambition: State Energy Taxes and the Question of Imported Electricity

By Daniel A. Himebaugh

Note from the Editor:

This article discusses the extraterritoriality doctrine and whether and how it might apply to carbon taxes adopted at the state level.

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This short article examines how the extraterritoriality doctrine might apply to state energy taxes imposed on electricity that is generated in one state but used in a different taxing state, when the purpose of the tax is to discourage greenhouse gas emissions. The extraterritoriality doctrine precludes a state from regulating commerce occurring wholly outside the state's borders.[1] This limitation on states' ability to regulate commerce beyond state lines stems from the Supreme Court's dormant commerce clause jurisprudence, which establishes that the Commerce Clause implicitly curtails state regulation of interstate commerce.[2]

My objective is to highlight some recent cases applying the extraterritoriality doctrine in order to explore how a court might analyze the constitutionality of a state "carbon" tax on imported electricity, recognizing that while state laws may terminate at state lines, the electrical grid does not. I specifically focus on Washington state because it has recently been a hotbed of activity on energy taxes, including several proposals for carbon taxes that would have taxed the sale of coal-based electricity generated at power plants located beyond Washington's borders. Moreover, I hope to show that while the extraterritoriality doctrine itself may not be uniformly embraced in the courts, case law counsels that the doctrine should be respected when evaluating the legality of state taxes on imported electricity.

Part I covers two recent Court of Appeals cases that stake out markedly different approaches to the extraterritoriality doctrine. With these cases in the background, Part II looks at proposed Washington state taxes on imported electricity that might become a blueprint for similar efforts in other states. Part III discusses the Ninth Circuit's precedent on the extraterritoriality doctrine, finding that the doctrine is very much alive in that circuit—the circuit where a challenge to a state energy tax is most likely to occur. Part IV concludes with some remarks about the way a constitutional challenge to a state tax on imported electricity might unfold.

I. The Extraterritoriality Doctrine: Dead or Alive?

A. *Energy and Environment Legal Institute v. Epel*

In the 2015 case *Energy and Environment Legal Institute v. Epel*, then-Judge Neil Gorsuch wrote an opinion for the Tenth Circuit upholding Colorado's renewable energy law against a dormant commerce clause challenge.[3] The state law at the center of *Epel* required electricity suppliers in Colorado to ensure that a portion of the electricity they sold to Coloradans was generated with renewable resources.[4] The plaintiffs challenging the Colorado

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1 Healy v. Beer Inst., 491 U.S. 324, 332 (1989).

2 Comptroller of the Treasury v. Wynne, 135 S. Ct. 1787, 1794 (2015).

3 Energy & Env't. Legal Inst. v. Epel, 793 F.3d 1169, 1171 (10th Cir. 2015).

4 *Id.* at 1170.

law brought suit under the extraterritoriality doctrine of the dormant commerce clause.[5]

The Tenth Circuit identified a series of U.S. Supreme Court opinions deeming "almost *per se* invalid" a category of state laws that control conduct taking place beyond the geographic boundaries of the state.[6] These opinions, which form the foundation of the extraterritoriality doctrine, establish a constitutional test that has been framed in various ways, asking whether a state law has "the practical effect of . . . control[ling] conduct beyond the boundary of the state,"[7] whether a state is "project[ing] its legislation"[8] into another state, or whether a state law regulates prices in out-of-state transactions.[9]

While acknowledging the viability of the extraterritoriality doctrine, the *Epel* court expressed remarkable skepticism about it, opining that the doctrine is the "least understood" and "most dormant" strand of dormant commerce clause jurisprudence.[10] Indeed, the extraterritoriality doctrine did not help the plaintiffs in *Epel*, as the court only grudgingly conceded that the doctrine might still exist.[11] The court limited the extraterritoriality doctrine to cases involving price controls—which did not undermine Colorado's energy law—and closed the book on the lawsuit.[12]

B. *North Dakota v. Heydinger*

Reading *Epel* in isolation would create the impression that the extraterritoriality doctrine is on its way to obsolescence. But another opinion involving a state energy law, published a year after *Epel* and in a different circuit, rejuvenated the extraterritoriality doctrine.[13]

In *North Dakota v. Heydinger*, Judge James Loken penned the lead opinion invalidating a Minnesota greenhouse gas emissions statute.[14] Several electricity suppliers who wanted to do business in the Midcontinent Independent System Operator (MISO) territory—a regional electric grid that includes Minnesota—struggled to arrange power purchase agreements to supply electricity generated by coal-fired plants located outside Minnesota due to concerns that such agreements would violate a Minnesota statute prohibiting the importation of electricity into Minnesota from certain facilities that contribute to carbon dioxide emissions.[15] The statute in *Heydinger* did not survive under the extraterritoriality doctrine, according to Judge Loken.[16] He applied a rule declaring that a state statute is invalid per se if its practical effect is to control conduct beyond the boundaries of the state, which includes requiring people or businesses to conduct their out-of-state commerce in a certain way.[17]

As the Eighth Circuit saw it, the practical effect of the Minnesota statute was to reduce emissions occurring outside Minnesota by prohibiting transactions that originated at a generation source outside Minnesota.[18] This extraterritorial control, said Judge Loken, meant that other states in the MISO region, which are interconnected by an electric grid transmitting electricity from numerous generation sources in a manner that is impossible to trace, would have to abide by Minnesota's policy whenever generating capacity was added to the regional grid.[19] According to Judge Loken, "[t]his Minnesota may not do without the approval of Congress."[20]

II. State Energy Taxes

Washington state has been center stage in a public policy debate about proposals to impose state taxes on greenhouse gas emissions. Numerous bills seeking to establish the nation's first

5 *Id.* at 1172.

6 *Epel*, 793 F.3d at 1172. The *Epel* court traced the origin of the extraterritoriality doctrine to *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935). *Epel*, 793 F.3d at 1172. *See also* Chad DeVeaux, *One Toke Too Far: The Demise of the Dormant Commerce Clause's Extraterritoriality Doctrine Threatens the Marijuana-Legalization Experiment*, 58 B.C. L. Rev. 953, 962-67 (2017) (tracing development of the extraterritoriality doctrine in case law); Tessa Gellerson, *Extraterritoriality and the Electric Grid:* North Dakota v. Heydinger*, A Case Study for State Energy Regulation*, 41 Harv. Envtl. L. Rev. 563, 569-81 (2017) (same); David M. Driesen, *Must the States Discriminate Against Their Own Producers Under the Dormant Commerce Clause?*, 54 Hous. L. Rev. 1, 15-30 (2016) (same).

7 Rocky Mountain Farmers Union v. Corey, 730 F.3d 1070, 1101 (9th Cir. 2013) (quoting *Healy*, 491 U.S. at 336).

8 *Baldwin*, 294 U.S. at 521.

9 Pharm. Research & Mfrs. of Am. v. Walsh, 538 U.S. 644, 669 (2003) (citing *Healy*, 491 U.S. at 324). *Accord* Ass'n for Accessible Medicines v. Frosh, 887 F.3d 664, 667-74 (4th Cir. 2018).

10 *Epel*, 793 F.3d at 1172. Further, the *Epel* Court questioned whether the extraterritoriality doctrine really established a separate test under the dormant commerce clause. *Id.* at 1173. *Accord* New York Pet Welfare Ass'n v. City of New York, 850 F.3d 79, 91-92 (2d Cir. 2017).

11 *Epel*, 793 F.3d at 1173.

12 *Id.*

13 North Dakota v. Heydinger, 825 F.3d 912, 913-23 (8th Cir. 2016) (Loken, J.).

14 *Heydinger*, 825 F.3d at 913-14.

15 *Id.* at 916-17. The MISO controls over 49,000 miles of transmission lines on a grid that covers fifteen states and parts of Canada. *Id.* at 915.

16 *Id.* at 919-22.

17 *Id.* at 919 (quoting Cotto Waxo Co. v. Williams, 46 F.3d 790, 793 (8th Cir. 1995)). Additionally, Judge Loken disagreed with *Epel*'s conclusion that the extraterritoriality doctrine only applies to price control statutes. *Heydinger*, 825 F.3d at 920.

18 *Id.* at 921.

19 *Id.* Judge Loken found that generators in MISO cannot prevent energy they place on the grid to serve non-Minnesota customers from being imported into Minnesota, and a Minnesota electricity supplier cannot do business with out-of-state generators without importing electricity from their coal-fired facilities. *Id. But cf.* Elissa Walter, *Flow or Oscillate? The Mismatch Between the Language Judges and Attorneys Use to Describe Electricity and the Actual Behavior of Electricity on the Grid*, 44 Ecology L.Q. 343, 362-65 (2017) (arguing that Judge Loken's analysis misunderstands the electric grid).

20 *Heydinger*, 825 F.3d at 922.

carbon tax in Washington have been introduced in the legislature in recent sessions,[21] and a 2016 ballot initiative failed to pass.[22]

Some of these proposals would have imposed a tax on emissions attributable to imported electricity, meaning electricity that is generated outside the state of Washington.[23] Imposing a tax on emissions attributable to imported electricity requires the taxing state to calculate and assign a value representing the emissions created by the production of electricity at an out-of-state generation source.[24] The tax would be collected from a legally responsible party at the first taxable transaction in the state, such as a utility supplying electricity in Washington, but the real targets of such taxes—the entities whose behavior they are meant to affect—are the out-of-state generation facilities that burn fossil fuels.[25]

Energy tax proponents hope that such taxes will discourage the use of heavily taxed products because those products, such as coal-based electricity, have greater emissions.[26] However, a grand design to transform a regional energy market by shaping behavior through taxation at the state level raises legal questions about any single state's ability to project its policy preferences into other states.[27] This is especially important for Washington to consider: Washington is home to only one coal-fired power plant, which is scheduled to shut down.[28] But some of Washington's neighboring states in the West have more coal plants and continue to serve Washington customers.[29] An energy tax that speeds the demise of another state's coal facilities could prompt close examination under the extraterritoriality doctrine.[30]

On one hand, *Epel* might signal that the extraterritoriality doctrine is not a concern for the kind of energy tax legislation that has been proposed in Washington in recent years. Strictly speaking, a state energy tax does not share many of the characteristics of the price control laws the *Epel* court singled out.[31] And the big question raised by *Epel* is whether the extraterritoriality doctrine has anything left to say at all.

But betting that the extraterritoriality doctrine will not apply in the case of a state energy tax is a real gamble after *Heydinger*. Judge Loken's opinion will continue to cast doubt on the constitutionality of state laws that have the practical effect of controlling commercial conduct taking place in other states.[32] A state tax that is intended to remake a regional energy market—particularly a tax that purposefully increases the price of a specific product originating in another state in order to drive that product into extinction—will be scrutinized under the extraterritoriality doctrine in courts that adopt the *Heydinger* approach.[33]

III. The Extraterritoriality Doctrine in the Ninth Circuit

A. *Rocky Mountain Farmers Union v. Corey*

In addition to reviewing Justice Gorsuch's narrow approach in the Tenth Circuit and Judge Loken's broader approach in the Eighth Circuit, anyone wanting to know how the extraterritoriality doctrine might apply in Washington or other west coast states should look to Ninth Circuit opinions.

The Ninth Circuit's 2013 opinion in *Rocky Mountain Farmers Union v. Corey* is a good place to start.[34] *Corey* was a dormant commerce clause challenge to California's low carbon fuel standard program.[35] Under that program, California regulated the carbon intensity of various fuels used for transportation, requiring fuel producers to meet state benchmarks for greenhouse gas emissions attributable to fuel.[36] Determining the carbon intensity of a given fuel involved a lifecycle analysis of the emissions associated with that fuel based on numerous factors, including the efficiency of production, source of electricity used at the production facility, and whether land was converted for production.[37] Many of these activities associated with fuel production took place before the fuel entered California.

Among other claims, the plaintiffs in *Corey* contended that the low carbon fuel standard impermissibly regulated extraterritorial conduct in violation of the dormant commerce clause.[38] In analyzing that claim, the court confirmed that the extraterritoriality doctrine is a cognizable legal theory in the Ninth Circuit.[39] The court tethered its opinion to the Supreme

21 *E.g.*, SB 5385 (2018); SB 5509 (2018); SB 6096 (2018); SB 6203 (2018); SB 6335 (2018).

22 Secretary of State Kim Wyman, *November 8, 2016 General Election Results, Initiative Measure No. 732 concerns taxes*, (April 10, 2018, 9:14 AM), http://results.vote.wa.gov/results/20161108/State-Measures-Initiative-Measure-No-732-concerns-taxes.html. I-732 failed in the 2016 general election 40.75 percent to 59.25 percent. *Id.*

23 *E.g.*, 2SSB 6203 (2018) (imposing a carbon pollution tax on the import for consumption to Washington of electricity generated through the combustion of fossil fuels).

24 *Id.*

25 *Id.*

26 Jay Inslee, *Our State, Our Destiny* 6-7 (Jan. 9, 2018) ("It is time to step up and give our citizens what they demand and deserve . . . which is a fight against climate change and the damaging health effects of carbon pollution. . . . Now is the time to join in action and put a price on carbon pollution.").

27 *Heydinger*, 825 F.3d at 913-23.

28 *See* Wash. Rev. Code § 80.82.010 (2018).

29 Energy Information Administration, U.S. Energy Mapping System, https://www.eia.gov/state/maps.php (May 22, 2018).

30 *Id.*

31 *Epel*, 793 F.3d at 1172-73.

32 *Heydinger*, 825 F.3d at 913-23.

33 *Id.* Moreover, a recent article on the extraterritoriality doctrine argues that the Supreme Court expanded the extraterritoriality doctrine in a case ignored by *Epel*, such that the doctrine applies with full force where a state seeks to impose economic sanctions that punish an out-of-state actor for conduct that was lawful in the state where it occurred. DeVeaux, *supra* n.8 at 966.

34 730 F.3d at 1077.

35 *Id.*

36 *Id.* at 1080.

37 *Id.* at 1083.

38 *Id.* at 1087.

39 *Id.* at 1101-06.

Court's *Healy* decision, which established that the critical inquiry for extraterritoriality analysis is "whether the practical effect of the regulation is to control conduct beyond the boundary of the state."[40] The Ninth Circuit also relied on the Supreme Court's decision in *C & A Carbone, Inc. v. Town of Clarkstown*—a case involving an ordinance that required waste to be processed at a town's transfer station—as an example showing that the extraterritoriality doctrine may apply to cases involving environmental regulations and is not limited to price control laws.[41] And the Ninth Circuit even endorsed the plaintiffs' assertion that a state's police power does not allow it to "invade [another state] to force reductions in greenhouse gas emissions."[42]

But that is as far as the *Corey* plaintiffs could carry their case. Applying the extraterritoriality doctrine, the Ninth Circuit found that California's low carbon fuel standard did not have the practical effect of controlling conduct outside the state.[43] The court instead viewed the California program as a system that probably will influence out-of-state fuel producers as they make commercial decisions about their fuel blends, but which does not actually mandate compliance with any particular California policy in out-of-state transactions.[44]

B. *Sam Francis Foundation v. Christie's, Inc.*

Nevertheless, the *Corey* plaintiffs' failure to prevail under the extraterritoriality doctrine should not be taken to mean that the Ninth Circuit will always reject claims pursued under the doctrine. Two years after *Corey*, the Ninth Circuit, sitting en banc in *Sam Francis Foundation v. Christie's, Inc.*, fully embraced the extraterritoriality doctrine and used it to partially strike down a California law.[45]

The ill-fated state law in *Christie's* was the California Resale Royalty Act.[46] The Act required a seller of fine art to pay five percent of the sale price to the artist if the seller resided in California.[47] The Ninth Circuit "easily" concluded that the Act violated the dormant commerce clause under the "simple" and "well established" extraterritoriality doctrine.[48] As the court explained, Supreme Court precedent provides that the dormant commerce clause precludes state statutes that regulate commerce beyond a state's borders.[49] The California law in *Christie's* squarely fell within the extraterritoriality doctrine's perimeter because it directly regulated some art sales that would occur entirely outside California.[50]

Christie's stands as strong confirmation that the Ninth Circuit will apply the extraterritoriality doctrine to test state laws' compliance with the dormant commerce clause. Moreover, the Ninth Circuit's opinions in *Corey* and *Christie's* show that it will apply the extraterritoriality doctrine in a wide variety of cases, in contrast to the Tenth Circuit's tightly circumscribed approach limiting the doctrine to price controls.[51]

IV. Conclusion

This brief survey of recent cases applying the extraterritoriality doctrine highlights one important constitutional consideration relating to state energy taxes on imported electricity. Taxing coal-based electricity in order to make it less competitive might look to some like sound environmental policy, but it can also be seen as one state's unconstitutional push to regulate interstate commerce by asserting control over out-of-state facilities. A state tax on imported electricity may be especially vulnerable to this critique in a state like Washington that has comparatively few coal-fired facilities vis-à-vis its neighbors—even more so if the patent purpose of the tax is to wear down a particular industry that mainly operates beyond Washington's borders.[52]

There are counterarguments. For one, the *Epel* decision may have weakened the extraterritoriality doctrine as applied to energy laws.[53] Another court might adopt *Epel*'s reasoning and conclude that a state energy tax on imported electricity—like a renewables mandate—does not raise constitutional red flags. That scenario, however, is unlikely to play out in the Ninth Circuit, where *Corey* and *Christie's* demonstrate that the extraterritoriality doctrine still holds sway.[54]

Alternatively, a court might determine that a state energy tax on imported electricity is analogous to the program upheld by the Ninth Circuit in *Corey*—merely a decision by one state to pay a price for the "ill effects" of its electricity consumption, which incidentally affects interstate commerce without unconstitutionally regulating it.[55] This outcome is difficult to predict because it would largely depend on the details of a specific case and how the challenged state law actually functioned in relationship to other states.

In the end, if a case is eventually presented, a court will be asked to decide whether a state tax on imported electricity that seeks to phase out a specific generation resource primarily used out of state violates the dormant commerce clause. The answer

40 *Id.* at 1101 (quoting *Healy*, 491 U.S. at 336).

41 *Id.* at 1102 (quoting C & A Carbone, Inc. v. Town of Clarkstown, 511 U.S. 383, 393 (1994)). "States and localities may not attach restrictions to exports and imports in order to control commerce in other States." *C & A Carbone, Inc.*, 511 U.S. at 393. *Accord* Nat'l Solid Wastes Mgmt. Ass'n v. Meyer, 165 F.3d 1151, 1153 (7th Cir. 1999).

42 *Corey*, 730 F.3d at 1103 (quoting Massachusetts v. EPA, 549 U.S. 497, 519 (2007)).

43 *Id.* at 1106.

44 *Id.*

45 784 F.3d 1320, 1322 (9th Cir. 2015).

46 *Id.*

47 *Id.*

48 *Id.* at 1323, 1325.

49 *Id.* at 1323-25.

50 *Id.* To explain the workings of the law, the court hypothesized that the California law would require a California resident temporarily living in New York who purchased art from a North Dakota artist in New York and then sold the art to her friend in New York to remit five percent of the sale price to the North Dakota artist. *Id.* at 1323.

51 *Epel*, 793 F.3d at 1173.

52 *See Heydinger*, 825 F.3d at 919-22.

53 *Epel*, 793 F.3d at 1173.

54 *Christie's, Inc.*, 784 F.3d at 1323-25; *Corey*, 730 F.3d at 1101-06.

55 *Corey*, 730 F.3d at 1106.

to that question will have major ramifications for state regulatory authority in the energy arena going forward.