Legal Assessment of Clean Heat Standard (CHS)

Senate Natural Resources Committee

April 8, 2022

Geoff Hand

Dunkiel Saunders Elliott Raubvogel & Hand PLLC

Scope of CHS Review

- State jurisdiction to regulate heating fuels & implement a CHS.

- Federal constitution limitations on state jurisdiction:
  – Dormant Commerce Clause
  – Preemption under the Supremacy Clause

- Thoughts on obligated/regulated parties with these legal parameters in mind.

Jurisdiction to Implement a Clean Heat Standard

- Vermont, as with all the states, exercises the authority of a sovereign entity within its borders.

- Chief among these sovereign powers is the state's "police power"—the ability to make laws and regulate for the public's health, safety, and well-being.

- Federal courts recognize that a state's energy policy and regulation of the energy industry are regarded as some of the most important functions of this police power.

- "Air pollution prevention falls under the broad police powers of the states, which include the power to protect the health of citizens in the state." *Exxon Mobil Corp. v. U.S. Envtl. Prot. Agency*, 217 F.3d 1246, 1255 (9th Cir. 2000).

- Similarly, it is well settled that the states have a legitimate interest in combating the adverse effects of climate change on their residents. *Massachusetts v. EPA*, 549 U.S. 497, 522–23 (2007).

Existing Regulations Relating to Heating Fuels

Within the heating fuel industry, Vermont already regulates for public health, environmental, and consumer protection purposes in numerous ways:

- Sulfur content in heating oil - 10 V.S.A. § 585;
- Licensing fees for petroleum clean up for bulk heating fuel - 10 V.S.A. § 1942;
- Tax on heating oil and propane for weatherization initiative - 33 V.S.A. § 2503;
- AG's Consumer Protection Rule 111 for propane dealers;
- Authority for State Strategic Oil Set-Aside. 9 V.S.A. § 4133.

Like the Clean Heat Standard proposal, these programs apply to voluntary commercial transactions for products sold into Vermont for use in the state.

Dormant Commerce Clause

- The Commerce Clause of U.S. Constitution grants Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian tribes." U.S. Const. art. I, § 8, cl. 3

- Implied in this express grant is a corresponding restraint that denies States the power to unjustifiably discriminate against or burden the interstate flow of articles of commerce – commonly referred to as the Dormant Commerce Clause.

- The primary concern of the "Dormant Commerce Clause" doctrine is to prevent "economic protectionism—that is, regulatory mechanisms designed to benefit in-state economic interests by burdening out-of-state competitors." *Dep't. of Revenue of Ky. v. Davis*, 553 U.S. 328, 337–38 (2008).

Dormant Commerce Clause Cont.

When evaluating Dormant Commerce Clause questions, courts typically consider three questions:

1. **Does the law discriminate between in-state and out-of-state interests?** Discrimination under the Dormant Commerce Clause means "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." Discrimination can be present in the plain text of the law ("facial" discrimination) or can appear in evidence demonstrating that the purpose or practical effect of the law is to discriminate.

2. **Does the law regulate commerce occurring entirely outside of the state?** Such "extraterritorial" laws are invalid to the extent they regulate transactions <u>wholly</u> outside of the state. However, this requirement is not designed to prevent out-of-state "ripple effects" from transactions involving an in-state party.

3. **Does the law impose a burden on interstate commerce that "is clearly excessive in relation to the putative local benefits?"** This final question is far more permissive then the previous two and involves a fact-specific balancing test (Pike Test). Most laws at this stage are upheld.

Decisions on Similar State Programs

<u>CA Low Carbon Fuel Standard</u>

Regulations set standards to reduce GHG emissions attributable to CA's fuel market. Fuel blenders required to keep average carbon intensity below the standard's annual limit. Fuels generate credits or deficits based on carbon intensity. Fuels evaluated on life-cycle emissions and regulation creates a system of tradeable credits.

Upheld by 9th Circuit Court of Appeals – *Rocky Mountain Farmers Union v. Corey*, 730 F.3d 1070, 1080 (9th Cir. 2013).

- Found that distinguishing between types of fuel products based on carbon intensity does not violate DCC and is proper exercise of state regulatory authority to address a recognized environmental concern.
- Not an extraterritorial application – "[state] cannot peacefully impose its own regulatory standards on another jurisdiction. But California may regulate with reference to local harms, structuring its internal markets to set incentives for firms to produce less harmful products for sale in California."

Decisions on Similar State Programs, Cont.

Oregon Clean Fuels Program

Similar in design to CA program.

Upheld on similar grounds. *Am. Fuel & Petrochemical Manufacturers v. O'Keeffe*, 903 F.3d 903 (9th Cir. 2018).

- "Oregon program distinguishes among fuels not on the basis of origin, but rather on carbon intensity…. The fact that the Program labels fuels by state of origin does not render it discriminatory, as these labels are not the basis for any differential treatment."
- No discriminatory purpose: "purpose of the Program is simply to 'reduce Oregon's contribution to the global levels of greenhouse gas emissions and the impacts of those emissions in Oregon'…. "We will assume that the objectives articulated by the legislature are actual purposes of the statute, unless an examination of the circumstances forces us to conclude that they could not have been a goal of the legislation."
- Contemporaneous statements by public officials explaining the program, "do not plausibly relate to a discriminatory design and are 'easily understood, in context, as economic defense of a [regulation] genuinely proposed for environmental reasons.'"

Decisions on Similar State Programs, Cont.

<u>Conn. Electric Renewable Portfolio Standard</u>

- Required Conn. utilities to have set % of electricity from renewable sources; utility could generate renewable power itself or purchase Renewable Energy Certificates ("RECs") from facilities in set geographic region – in this case the ISO NE region.
- Solar developer with a project outside ISO-NE region challenged statute as discriminatory under DCC because RECs produced by its project were not eligible for participation in program.

Upheld by 2nd Cir. Court of Appeals. *Allco Finance Ltd. v. Klee*, 861 F.3d 82 (2d. Cir. 2018).

- Found geographic limitation appropriate give stated goals – increased in-region renewable energy production would improve air quality for Conn citizens and protect them from price and supply shocks that could result if, for example, there was a natural gas shortage.
- Also found RECs are created by state law, and states can define differently based on state goals. Other RECs that do not meet definition are not "similarly situated" products for purposes of evaluating competitive impacts under DCC

Preemption Doctrine

- Preemption Doctrine stems from the Supremacy Clause of the U.S. Constitution:

  The laws of the United States are "the supreme Law of the Land ... any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI cl. 2.

- Federal preemption of state laws may be either express or implied:
  - Express preemption occurs where plain language of a federal statute indicates that Congress intended to preempt state law.
  - Implied preemption takes two forms = "field" preemption or "conflict" preemption. Field preemption applies when the Congressional scheme clearly occupies an entire field of regulation, leaving no room for the States to supplement. Conflict preemption occurs when compliance with both state and federal law is impossible, or where the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

Preemption Doctrine Cont.

1. Natural Gas Act (NGA) – Provides federal regulatory (FERC) authority over interstate natural gas transportation and wholesale transactions; leaving states to regulate the production and retail distribution of natural gas.

2. Clean Air Act (CAA) – Regulates air pollution emissions from both stationary and mobile sources. The CAA, like the NGA, relies on both state and federal regulation. States have substantial flexibility to regulate stationary sources more stringently than federal baseline.

3. EPA's Renewable Fuel Standard – A 2005 amendment to the CAA to increase domestic renewable fuels production, reduce emissions, and limit oil imports, requires fuel refiners and importers to blend a certain volume of renewable fuel. Courts have held that stricter state renewable fuel limits are complementary to the goals of this program.

4. Energy Policy and Conservation Act - Among other programs, provides U.S. Dep't of Energy authority to regulate the efficiency of appliances and building practices, and includes the Energy Star program.

As summarized in our memo, the CHS as presently proposed does not raise any preemption concerns under any of these federal statutory programs.

Obligated/Regulated Parties

Question of where to impose the regulatory obligation is important, both with respect to the practical application and administration of the program, as well as the legal issues discussed above.

1. Obligation should not discriminate based on origin – apply equally to in-state and out-of-state producers/importers/suppliers.

2. Should apply only to jurisdictional transactions occurring within the State – and should be clear about what is excluded (e.g., transport of fuel through the state to be used exclusively in other states).

3. Should consider applying as far up the chain as possible with jurisdictional limitations in mind – wholesale transaction at bulk storage facility after production or importation, or if wholesale transaction occurs outside the state, at the point of first sale in the state after importation.

4. Obligations for regulated natural gas distribution utility (VGS) should be based on sales at the distribution level.

Obligated/Regulated Party Examples.

- CA – “The first fuel reporting entity for liquid fuels is the producer or importer of the liquid fuel.” Cal. Code Regs. tit. 17, § 95483.
- Oregon- “The regulated party is the producer or importer of the regulated fuel…” Or. Admin. R. 340-253-0000-8100.

Vermont example:

- 23 V.S.A § 3101 - (1) "Distributor" means a person who imports or causes to be imported gasoline or other motor fuel for use, distribution, or sale within the State, or any person who produces, refines, manufactures, or compounds gasoline or other motor fuel within the State for use, distribution, or sale….”

Proposed CHS Language in H.715:

- Sec. 8122 (7) “Obligated party” means: (A) a regulated natural gas utility serving customers in Vermont; or (B) for other heating fuels, the entity that makes the first sale of the heating fuel into or in the State for consumption within the State.

Questions?

Presentation based on memo prepared for Clean Heat Standard Working Group by Geoff Hand, Malachi Brennan, Vic Westgate, and Paul Quackenbush.

Available at: https://www.eanvt.org/chs-legal-memo/

For any further follow-up questions feel free to contact:
ghand@dunkielsaunders.com