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MEMORANDUM

TO: Bram Claeys, Massachusetts Department of Energy Resources

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CC: Wendy Jacobs and Shaun Goho

DATE: May 6, 2015

RE: Dormant Commerce Clause Analysis of a Mandatory Pellet Standard

I. INTRODUCTION

The Massachusetts Department of Energy Resources ("DOER") is exploring whether to adopt mandatory wood pellet standards for all pellets sold in the Commonwealth; these standards might relate to pellets' composition, conformation, and supply chain.[1] DOER is also investigating whether to work with other interested states (especially in the Northeast) to create a regional pellet standard. You have asked us to research whether a potential Massachusetts or regional wood pellet standard would face problems under the dormant Commerce Clause doctrine. We conclude that a properly crafted pellet standard would not violate the dormant Commerce Clause because it would not discriminate against interstate commerce, would benefit a legitimate local interest more than it would burden interstate commerce, and would not regulate extraterritorially.

II. DORMANT COMMERCE CLAUSE ANALYSIS

Under the Commerce Clause of the Constitution "Congress shall have Power . . . [t]o regulate Commerce . . . among the several States." Art. I, § 8, cl. 3. Courts have long interpreted the Commerce power to contain a negative, or "dormant," aspect that prevents states from burdening interstate commerce by imposing economically protectionist laws. *Oregon Waste Sys., Inc. v. Dep't of Envtl. Quality of State of Or.*, 511 U.S. 93, 98 (1994).

Historically, the dormant Commerce Clause has been "understood to protect free trade and prohibit States from placing themselves in a position of economic isolation." *United*

[1] For the purposes of this memorandum, we use "supply chain" to refer to all potential regulation regarding where the wood comprising pellets is sourced and tracking wood through the chain of custody. "Conformation" refers to regulations regarding pellet shape, size, and density. "Composition" refers to the chemical and physical make up of pellets, including impurities, ash, and other chemical properties.

Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth., 550 U.S. 330, 364 (2007) (internal quotation marks and alteration omitted). However, "the States retain 'broad power' to legislate protection for their citizens in matters of local concern such as public health." *Great Atl. & Pac. Tea Co. v. Cottrell*, 424 U.S. 366, 370 (1976). In reviewing claims that state laws[2] violate the dormant Commerce Clause, courts attempt to strike a balance that satisfies national concerns about economic protectionism, while also preserving local autonomy. *Dep't of Revenue of Ky. v. Davis*, 553 U.S. 328, 328 (2008).

A state or local law may violate the Dormant Commerce Clause if it (1) discriminates against interstate commerce on its face or in purpose or effect; (2) imposes an incidental burden on interstate commerce that is clearly excessive in relation to local benefits; or (3) has an extraterritorial reach. *See Pharm. Research & Mfrs. of Am. v. Concannon*, 249 F.3d 66, 79-80 (1st Cir. 2001). Under this test, if a regulation is discriminatory under prong (1) or extraterritorial under prong (3), the regulation is subject to a standard of review known as strict scrutiny and usually struck down. *See id.* If the law is not facially discriminatory or extraterritorial in application, and instead has only "incidental effects" on interstate commerce, courts engage in a balancing analysis under what is known as the *Pike* framework, asking whether "the burden imposed on . . . commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

A. Discriminatory Laws Are Subject to Strict Scrutiny.

In the commerce clause context, "'discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Sys., Inc.*, 511 U.S. at 99. A law may be discriminatory in two different ways. First, the discrimination might be obvious from the text of the law; in this case, the law is said to be "facially discriminatory" or discriminatory "on its face." Second, a law that is not facially discriminatory may nevertheless have the purpose or effect of "favor[ing] in-state economic interests over out-of-state interests." *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 579 (1986).

If a law discriminates on its face or in purpose or effect, courts will apply a standard of review known as strict scrutiny. *See Oregon Waste Sys., Inc.* 511 U.S. at 101. Under this standard, the state must prove that the law has a legitimate, or non-protectionist, purpose, and that there is no less discriminatory means for achieving that purpose. *See New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1988). Because there is almost always a less discriminatory means available, "the state's burden of justification is so heavy" that strict scrutiny almost always results in the law being struck down. *Oregon Waste Sys., Inc.*, 511 U.S. at 101. The U.S. Supreme Court, for example, has only ever upheld one law that it found to be discriminatory under modern dormant Commerce Clause doctrine. *See Maine v. Taylor*, 477 U.S. 131, 151 (1986) (upholding Maine statute banning importation of out-of-state baitfish because no nondiscriminatory alternative existed to prevent introduction of nonnative parasites into Maine waters).

[2] Throughout this memorandum, we refer to state "laws," but all of the discussion applies equally to laws and to regulations.

1. A Pellet Standard Can Be Designed so That It Is Not Facially Discriminatory.

Laws are facially discriminatory when they explicitly treat in-state and out-of-state interests differently. The classic example of facial discrimination is a tariff on goods entering a state. *See Welton v. State of Missouri*, 91 U.S. 275, 283 (1875). The Supreme Court has also found facial discrimination when an ordinance required that all milk sold in a city be pasteurized within five miles of the city, *Dean Milk Co. v. City of Madison, Wis.*, 340 U.S. 349, 354 (1951), a flow control ordinance required that all town waste be processed at a particular station, *C & A Carbone, Inc. v. Town of Clarkstown, N.Y.*, 511 U.S. 383, 391 (1994), and a state law required that 10% of all coal used at any power plant within the state be mined in that state, *Wyoming v. Oklahoma*, 502 U.S. 437, 458 (1992). As these cases demonstrate, when locality or geography is included as a predicate condition of some element of a law, the law is significantly more vulnerable to a facial discrimination challenge.

Any pellet standard developed by the Commonwealth should not expressly favor local pellet producers at the expense of out-of-state producers. For example, the Commonwealth should avoid taxing pellets entering the Commonwealth without subjecting local producers to the same tax, requiring that pellets sold in Massachusetts be processed in Massachusetts, or mandating that a percentage of the wood used for pellets be harvested in Massachusetts.[3]

2. A Pellet Standard Can Be Designed so That It Is Not Discriminatory in Purpose or Effect.

Even if a law is not discriminatory on its face, it may still be discriminatory in purpose or effect. Laws are discriminatory in purpose or effect if, in practice, they "favor in-state economic interests over out-of-state interests." *Brown-Forman Distillers*, 476 U.S. at 579. For a law to be considered discriminatory, the complaining party must show "both how local economic actors are favored by the legislation, and how out-of-state actors are burdened by the legislation." *E. Kentucky Res. v. Fiscal Court of Magoffin Cnty., Ky.*, 127 F.3d 532, 543 (6th Cir. 1997).

The line between laws that are discriminatory in purpose or effect—which are subject to strict scrutiny—and laws that have only incidental burdens on interstate commerce—which are subject to more forgiving intermediate scrutiny under the *Pike* test discussed below—is not always clear. *See Pike*, 397 U.S. at 142. Some of the factors that courts consider include: whether the regulation excludes virtually all out-of-staters; whether costs are borne by out-of-staters that in-staters do not have to bear; and whether the court believes the motivation is protectionist. *See, e.g., Hunt v. Washington State Apple Adver. Comm'n*, 432 U.S. 333, 352 (1977) (holding that a facially neutral law was invalid under strict scrutiny because it had the effect of raising costs on out of state apple producers without imposing similar costs on in-state producers); *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 194 (1994) (holding unconstitutional a state regulation that taxed both in-state and out-of-state milk producers but only subsidized in-state producers because it had discriminatory effect).

[3] At the current time, there are no pellet producers based in Massachusetts, however.

There are several things that the Commonwealth can do to ensure that a pellet standard regulation is not found to be discriminatory in purpose or effect. First, the Commonwealth should develop a regulatory record that reflects the law's environmental purposes and the absence of any pellet producers in Massachusetts. Courts often look to documents supporting laws, such as legislative history, to determine whether the regulator's motives were protectionist or legitimate. *See, e.g., Alliance of Auto. Mfrs. v. Gwadosky*, 430 F.3d 30, 39 (1st Cir. 2005). By ensuring that the regulation is supported by a strong record showing the health and environmental benefits that pellet standards would confer upon Massachusetts citizens, the Commonwealth can show that its pellet standard does not have a discriminatory purpose.

Second, the Commonwealth should ensure that its regulation applies neutrally to in-state and out-of-state businesses. If the Commonwealth regulates the pellet supply chain to ensure that pellets come from sustainably managed forests, such regulations should be written so as to avoid any possibility that they could be misunderstood as having a protectionist motive. For example, the Commonwealth should not require that pellets be made from trees that are unique to Massachusetts or mandate a forest certification process that is inaccessible outside of Massachusetts. By avoiding provisions and statements that suggest that the regulation is intended to help local businesses, the Commonwealth would be able to demonstrate that the regulation was not discriminatory in purpose.

In one regard, Massachusetts pellet standards might place burdens on out-of-state businesses that in-state businesses would not have to bear, because Massachusetts does not contain any pellet producers at present.[4] Opponents of pellet standards might therefore argue that because Massachusetts does not produce pellets, the costs of any pellet regulation will be borne entirely by out-of-state businesses.[5] However, this view considers only half of the equation. Opponents must not only show that out-of-state economic interests are burdened, but also that in-state economic interests are favored by the regulation. *See E. Kentucky Res.*, 127 F.3d at 543. Here, the Commonwealth's regulation would not advance any local economic interest. Rather, the regulation would benefit in-state health and welfare, which is undoubtedly a legitimate local purpose. *See, e.g., United Haulers*, 550 U.S. at 344 (stating that courts are hesitant to interfere with regulations that are "typically and traditionally a function of local government exercising its police power").

B. Laws Imposing Incidental Burdens on Interstate Commerce Are Subject to *Pike* Balancing.

Under *Pike*, laws with only "incidental" effects on interstate commerce that regulate "even-handedly to effectuate a legitimate local public interest" will be upheld unless "the burden

[4] According to BioMass Magazine, only one company that produces wood pellets is located in Massachusetts. *Pellet Plants*, BIOMASS MAGAZINE, http://biomassmagazine.com/plants/listplants/pellet/US/ (last visited Apr. 21, 2015). This Massachusetts company is not yet operational, and once it is, it plans to produce pellets in Arkansas. *Id.*

[5] If a court found that the state standard was discriminatory in purpose or effect on this logic or otherwise, it would apply strict scrutiny. Under strict scrutiny, a law will only be upheld if it advances a non-discriminatory governmental interest and no less discriminatory means is available to achieve that interest. *See New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1988).

imposed on such commerce is clearly excessive in relation to the putative local benefits." *Pike*, 397 U.S. at 142. In examining the legitimacy of the law's local purpose, courts do not analyze the wisdom of a particular policy, but look only to whether the law's asserted aims are rationally related to its means. *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 464 (1981). "If a legitimate local purpose is found, then the question becomes one of degree," and the court undertakes a balancing inquiry weighing "the nature of the local interest" against the burden on interstate commerce. *Pike*, 397 U.S. at 142. Under this deferential standard, "nondiscriminatory measures . . . are usually upheld." *W. Lynn Creamery, Inc.*, 512 U.S. at 214.

To satisfy the *Pike* test, the Commonwealth's regulations must address a matter of legitimate local interest. The Commonwealth would clearly have legitimate local interests for composition, conformation, and supply chain standards. Pellet composition and conformation standards would advance its legitimate interest in promoting local air quality and the health of Massachusetts citizens by lowering pellet heater emissions of fine particulate matter. Wood heaters are a significant source of particulate matter emissions and the EPA has found that fine particulate matter "ha[s] the greatest demonstrated impact on human health" of any air pollutant. "Particulate Matter Research," ENVIRONMENTAL PROTECTION AGENCY, http://www.epa.gov/airscience/air-particulatematter.htm, (last visited Apr. 21, 2015). The Supreme Court has held that environmental protection and resource conservation measures such as this are areas of legitimate local concern. *See, e.g., Clover Leaf Creamery Co.*, 449 U.S. at 471.

The Commonwealth also aims to adopt supply chain standards that ensure pellets come only from sustainably managed forests. By mandating sustainable practices, supply chain standards will reduce greenhouse gas emissions, thereby mitigating climate change, which is an issue of significant concern for Massachusetts. Massachusetts is at serious risk from the many effects of climate change, including extreme weather events, coastal inundation, and negative health effects. *See, e.g.*, MASSACHUSETTS EXECUTIVE OFFICE OF ENERGY AND ENVIRONMENTAL AFFAIRS, MASSACHUSETTS CLIMATE CHANGE ADAPTATION REPORT 2 (2011) (estimating that sea level rise alone could cause $463 billion in damages in Massachusetts). Given the massive scale of the risk of climate change, the benefits of adopting any greenhouse gas mitigation program, including supply chain standards, are also potentially substantial.

Neither the fact that the supply chain standards would function by reducing greenhouse gas emissions in other states, nor the fact that the threat of climate change is widely shared among the states diminishes the Commonwealth's substantial interest in mitigating climate change.[6] In 2013, the Ninth Circuit decided *Rocky Mountain Farmers v. Corey,* finding that the California low carbon fuel standard did not violate the Dormant Commerce Clause. *Rocky Mountain Farmers Union v. Corey*, 730 F.3d 1070, 1107 (9th Cir. 2013). The Ninth Circuit held that California had a legitimate local interest in reducing greenhouse gas emissions, despite the fact that reductions accrued out-of-state, because "[o]ne ton of carbon dioxide emitted when fuel is produced in Iowa or Brazil harms Californians as much as one emitted when fuel is consumed in Sacramento." *Id.* at 1081. In addition, the Supreme Court has found that although the effects

[6] In addition, supply chain standards can also help reduce local air pollution. In particular, they can bolster composition standards by tracking the pellet feedstock throughout the chain of custody from the forest to the pellet mill in order to ensure that the process results in clean pellets.

of climate change are "widely shared," this fact "does not minimize Massachusetts' interest" in limiting greenhouse gas emissions. *Massachusetts v. E.P.A.*, 549 U.S. 497, 499 (2007). These cases are persuasive evidence that a reviewing court would find that Massachusetts has a legitimate local interest in mitigating climate change, which is not diminished by the wide scope of the interest, nor by the fact that greenhouse gas reductions will accrue out-of-state.

After having found legitimate local interests justifying the composition, conformation and supply chain standards, a reviewing court would balance these interests against the burdens the standard imposes on interstate commerce. By comparison, the marginal burden a pellet standard would impose on commerce is not "clearly excessive," given that pellets are already regulated by a federal standard and that many forests already participate in sustainability certification programs. That burden would be further mitigated by the Commonwealth's efforts to develop a regional standard, which would consolidate the number of rules with which pellet producers must comply.

C. Laws with Extraterritorial Application Are Subject to Strict Scrutiny.

A statute violates the Dormant Commerce Clause as an extraterritorial application of state authority when it (1) "regulates commerce wholly outside the state's borders," (2) "has a practical effect of controlling conduct outside of the state," or (3) "necessarily requires out-of-state commerce to be conducted according to in-state terms." *Pharm. Research & Mfrs. of Am. v. Concannon*, 249 F.3d 66, 79 (1st Cir. 2001). "Generally speaking, the Commerce Clause protects against inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another State." *Healy v. Beer Inst., Inc.*, 491 U.S. 324, 336-337 (1989). When extraterritorial application is found, the law is subject to strict scrutiny regardless of legislative intent, and is usually struck down. *See Healy v. Beer Inst., Inc.*, 491 U.S. 324, 336 (1989).

Under the extraterritoriality doctrine, a state is free to regulate products entering its borders, but cannot reach beyond its borders to regulate an entire out-of-state jurisdiction, including people or entities who do not engage in any business in the state. For example, a Seventh Circuit decision struck down a law that required any out-of-state municipality that exported waste to Wisconsin to mandate recycling in compliance with Wisconsin standards. *See Nat'l Solid Wastes Mgmt. Ass'n v. Meyer*, 63 F.3d 652, 662 (7th Cir. 1995). The court struck down the Wisconsin law because its practical effect was to require out-of-state waste generators who would never export waste into Wisconsin to adhere to Wisconsin rules "at the pain of an absolute ban on interstate commerce" for any waste generator wishing to export into Wisconsin. *Id.* at 661. The court found that Wisconsin's law violated the dormant Commerce Clause because it banned certain waste "not because it is more noxious than waste produced the Wisconsin way, but simply because it comes from a community whose ways are not Wisconsin's ways." *Id.* at 662. Critical to the court's decision was the fact that "all citizens in the . . . community must observe the statute's recycling provisions, whether or not they actually dump waste in Wisconsin." *Id.* at 655.

A carefully-crafted pellet supply chain standard will not have the effect of imposing the state's regulations extraterritorially. For example, if the standards were written to apply only to importers of pellets or in-state pellet retailers, they would present no extraterritoriality problems.

The standards would only indirectly affect out-of-state businesses "should they choose to do business in Massachusetts," rather than affecting entire jurisdictions containing many individuals who are not engaged in commerce with Massachusetts. *Philip Morris, Inc. v. Reilly*, 267 F.3d 45, 64 (1st Cir. 2001) *on reh'g en banc,* 312 F.3d 24 (1st Cir. 2002) (distinguishing *National Solid Wastes Management* in upholding a Massachusetts law requiring that tobacco manufacturers disclose certain information on the packages of cigarettes sold in Massachusetts). In addition, supply chain standards may be distinguished from *National Solid Wastes Management* because it that case everyone in the exporting community had to adhere to the Wisconsin regulations. *Id*. By contrast, the pellet standards would only affect the forest owners and pellet manufacturers whose products end up being sold in Massachusetts; other members of their communities would be unaffected. In addition, it is likely that many forests already adhere to the sustainability practices that would be required by a Massachusetts supply chain standard. The Massachusetts standard would merely constrain importers' or retailers' choice among pellet producers, mandating that pellets sold in the state only from the pre-existing sustainable sources.

A close analogy to this situation is presented by the California low-carbon fuel standard case discussed above, *Rocky Mountain Farmers Union v. Corey*, 730 F.3d 1070 (9th Cir. 2013). In that case, the Ninth Circuit upheld a California law that aimed to mitigate climate change by grading fuels based on their life-cycle greenhouse gas emissions. *See id.* The court distinguished the California fuel standards from the impermissible attempt to directly regulate communities in *National Solid Wastes Management*, stating:

> The Fuel Standard . . . says nothing at all about ethanol produced, sold, and used outside California, it does not require other jurisdictions to adopt reciprocal standards before their ethanol can be sold in California . . . and it imposes no civil or criminal penalties on non-compliant transactions completed wholly out of state.

Id. at 1102-03. Like in *Rocky Mountain Farmers Union*, the Commonwealth's standards would not need to control individuals who are not engaged in commerce with Massachusetts. Instead, the standards could be designed so that any incidental burdens out-of-state businesses may incur will be borne by those engaged in commerce with the Commonwealth, namely the pellet manufacturers or forest owners. Such incidental burdens do not constitute extraterritorial regulation under the dormant Commerce Clause.