

ARTICLES

California, Climate Change, and the Constitution

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Editors' Summary: Climate change, like many environmental challenges, is a global problem requiring local solutions. While the United States has of yet not passed meaningful legislation that addresses climate change, several U.S. states are taking steps to reduce the carbon footprints of their industries and citizens. In this Article, Erwin Chemerinsky, Brigham Daniels, Brettny Hardy, Tim Profeta, Christopher H. Schroeder, and Neil S. Siegel describe the climate change policies proposed by one such U.S. state: California. The authors then examine the possible constitutional issues inherent in these policies, including the roles of the dormant Commerce Clause and the dormant foreign relations power in moderating state efforts at regulation.

Within this Article, we see footprints of two giants. The first is global warming, which holds the potential to become the single greatest environmental problem facing California, the United States, and even the world. California—along with a growing number of states—is taking unilateral actions to counter this threat. The second giant, the U.S. Constitution, restricts states' power to address certain problems and particularly limits the strategies states can employ to further the interests of their citizens. This Article serves as a practical road map for California and other states attempting to reduce greenhouse gas (GHG) emissions without violating the dictates of the Constitution.

To begin with, we recognize that state, federal, and global climate change policies affect every nation. The threat of climate change does not hinge on where GHG emissions occur. On the contrary, because these gases quickly assimilate into the global atmosphere, emissions in Florence, Italy, have the same global impact as those released in Florence, California.

Yet, even as the problem of climate change is a global one, its solutions are often inherently local. It is only through cumulative efforts of many that we have any hope of addressing the problem: climate change is well beyond the control of California or even any single nation. But it is not beyond

the grasp of the world, assuming enough of us muster enough will to do our part.

Our focus on California is well-deserved, as the state has placed itself on the vanguard of state-level climate change action. Most significantly, in September 2006, Gov. Arnold Schwarzenegger (R) signed into law California's Global Warming Solutions Act (AB 32).¹ AB 32 requires the California Air Resources Board to set limits to reduce California's GHG emissions to 1990 levels by the year 2020.² This law represents the nation's first statewide mandate to reduce GHG emissions across a state's entire economy. The Act does not specify how the Board should go about reducing emissions, but instead generally states that the Board will adopt regulations "to achieve the maximum technologically feasible and cost-effective greenhouse gas emission reductions" possible.³ In considering different options, it seems likely that the board will eventually promote a cap-and-trade program. Although the Act does not directly call upon the Board to use market-based solutions to reduce emissions, it seems that the Board, along with many of California's leaders, prefers a cap-and-trade program over other alternatives.

It is easy to characterize AB 32 as a logical progression of California's past actions related to climate change. The California Legislature has previously passed pioneering legislation that attempts to regulate GHG emissions from its automobile fleet.⁴ Additionally, about two months before signing AB 32, Governor Schwarzenegger signed an agreement with Prime Minister Tony Blair, providing for California and the United Kingdom to work cooperatively to ad-

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1. CAL. HEALTH & SAFETY CODE §§38501-38599 (West 2006).

2. 2006 Cal. Stat. 89.

3. *Id.*

4. 2002 Cal. Legis. Serv. ch. 200 (AB 1493) (West), *codified at* CAL. HEALTH & SAFETY CODE §43018.5(a) (West 2002).

dress climate change.⁵ The governor has issued an executive order that sets out an aggressive timeline for California to reduce its GHG emissions.⁶ Furthermore, California's state bureaucracy has taken some steps to address the issue: the California Public Utility Commission has instituted a process to cap GHG emissions for the state's electricity generators.⁷ California has also gone to great lengths to invest in research to help the state understand the stakes it has in the climate change debate and the policies it could pursue to address the problem.⁸

Given California's role as a state, extraordinary circumstances surround AB 32. Perhaps due to the stark contrast between California and the dearth of federal action on climate change, AB 32 has attracted the spotlight of the international stage. As Governor Schwarzenegger signed the legislation, national and international leaders showed their support and praised AB 32, including Prime Minister Blair and Gov. George Pataki (R-N.Y.). Prime Minister Blair noted that the signing ceremony represented a "historic day for the rest of the world as well."⁹ Indeed, the backdrop for the signing ceremony—more than 100 flags of the world's nations—highlights the unusual fanfare surrounding AB 32.

Outside of the media's spotlight, it is easy to imagine that many others have wondered how AB 32 might impact them. Presumably the shadow of AB 32 has created discomfort for the president and others in Washington, D.C., who have typically opposed taking firm action to address climate change. Indeed, comments, such as Governor Schwarzenegger's criticism of the federal government, rang out loud and clear in the press: "California will not wait for our federal government to take strong action on global warming."¹⁰ To some extent, those charged with negotiating our nation's treaties may have wondered if California's actions complicated the U.S. position at all. Additionally, those inside and outside the state who rely on the bounty of the California economy had to wonder whether they would help bear the cost of AB 32.

5. See, e.g., Carla Marinucci, *State, U.K. Strike Emissions Deal, Bypassing Bush*, S.F. CHRON., Aug. 1, 2006, at A1; Edwin Garcia & Paul Rogers, *Governor, Blair Sign Warming Accord*, SAN JOSE MERCURY NEWS (California), Aug. 1, 2006, at B1.

6. Cal. Exec. Order No. S-3-05 (June 1, 2005) (calling for a reduction in 2020 to 1990 levels and an additional reduction in 2050 to 80% below 1990 levels).

7. See Press Release, California Public Utilities Commission, PUC to Set Cap on Greenhouse Gas Emissions Produced While Generating Electricity (Feb. 16, 2006), available at http://www.cpuc.ca.gov/PUBLISHED/NEWS_RELEASE/53682.htm.

8. See GERRY BEMIS & JENNIFER ALLEN, CALIFORNIA ENERGY COMM'N, INVENTORY OF CALIFORNIA GREENHOUSE GAS EMISSIONS AND SINKS: 1990-2002 UPDATE (2005) (CEC-600-2005-025); SUSAN BROWN, CALIFORNIA ENERGY COMM'N, GLOBAL CLIMATE CHANGE AND CALIFORNIA (2005) (CEC-600-2005-007); CALIFORNIA CLIMATE CHANGE CTR., OUR CHANGING CLIMATE—ASSESSING THE RISKS TO CALIFORNIA (2006); DAN CAYAN ET AL., CALIFORNIA CLIMATE CHANGE CTR., SCENARIOS OF CLIMATE CHANGE IN CALIFORNIA: AN OVERVIEW (2006) (CEC-500-2005-186-SF); CLIMATE ACTION TEAM, CALIFORNIA ENVTL. PROTECTION AGENCY, CLIMATE ACTION TEAM REPORT TO GOVERNOR SCHWARZENEGGER AND THE LEGISLATURE (2006); GUIDO FRANCO, CALIFORNIA ENERGY COMM'N, CLIMATE CHANGE IMPACTS AND ADAPTATION IN CALIFORNIA (2005) (CEC-500-2005-103).

9. See *Arnie in War on Climate Change*, COURIER MAIL (Austl.), Sept. 29, 2006, at 41.

10. Guy Dinmore & Matthew Garrahan, *Californians Rush in Where Washington Fears to Tread*, FIN. TIMES (London), Oct. 7, 2006, at 8.

Because both the benefits and the costs of California's actions at least have the potential to extend beyond state lines, it should not be surprising that California's actions raise some serious questions about whether the state has overstepped or will overstep its bounds. Depending on how the Board implements AB 32, California's enactment may raise constitutional concerns, particularly if it settles on a cap-and-trade system that impacts interstate commerce or attempts to broaden the relevant GHG market by coordinating California's GHG markets with those created in other countries.

Part I of this Article focuses on how California's plan may implicate interstate commerce and, hence, the Constitution's dormant Commerce Clause. Specifically, this comes into play as the state attempts to confront "leakage," which is the problem of those regulated by the program relocating outside of California in order to avoid regulation. If California fails to address leakage, its system may impose burdens on Californians without achieving actual reductions in global warming gases. When attempting to stop system leakage, however, California must remain mindful of the Constitution's dormant Commerce Clause.

Part II of this Article discusses the possibility of extending California's market for emissions trading beyond its boundaries and perhaps even beyond the boundaries of the United States. For example, the European Union (EU), which already has a GHG cap-and-trade program in operation, seems like a sensible place for California to expand its market. To the extent that California considers counting reductions outside of the United States as reductions under California's program, California may trigger constitutional concerns under another dormant power in the Constitution: the dormant foreign relations power.

This Article is meant to provide California with some sound advice on the extent to which potential federal constitutional pitfalls surround the state's action. In writing this Article, we also understand that a growing number of states are on track to follow California's steps in short order. Given this, we also highlight the fact that the analysis contained in this Article has practical value for those outside California.

I. Leakage and the Dormant Commerce Clause

California's purpose behind its GHG reduction program is simple: to reduce its contribution to GHGs in the global atmosphere. Despite the simplicity of the goal, the state faces some significant challenges to creating an effective cap-and-trade system that genuinely achieves that result. One such barrier is that those outside California might undo any progress California makes inside its borders. In confronting a global problem, the fluid nature of the global economy can make it difficult to achieve and assess progress.

In order to ensure that any reductions within California translate to actual reductions of GHGs in the global atmosphere, the state implementing agencies will need to design a program that takes precautions to guarantee that gains from such reductions are not lost through GHG increases elsewhere. The concern that the dynamics of the larger economy could wash out efforts within California is commonly referred to as leakage. The danger in proceeding with indifference to leakage is that it could undermine California's goals.

Leakage is a common challenge for policies attempting to reduce undesirable activities. For example, when a municipal police force institutes an aggressive attack on illegal drug sales, drug sellers may relocate to other jurisdictions and continue their illegal business. This is a form of leakage. Within the electricity sector, relocating generating facilities to escape global warming regulation is implausible, at least in the short term, but the integrated, interstate electrical grid and the interchangeable nature of generated electricity allow for a different form of leakage. If global warming initiatives regulate electricity generation—which it almost certainly will—the market may respond by shifting production from facilities inside California to unregulated facilities outside the state. The risk of leakage grows out of several factors including transportation costs, the pollution intensity of the product, the ability of out-of-state producers to create similar products, the regulatory burden outside California, and the capacity of out-of-state producers to fill California reductions.

Leakage can reduce the effectiveness of a regulatory program, depending upon the program's objectives. If municipal police are only concerned about reducing crime in their city, then leakage is not a problem. If they are concerned about reducing crime within a larger region, however, leakage that simply shifts the incidence of crime from one area within that region to another undermines and may even completely negate the program's effects. Leakage is a problem for a California cap-and-trade program precisely because one of California's objectives is to reduce the impact that California has on climate change—a problem of global dimensions. If the reductions of global warming gases within California are largely displaced to other states, then the net effect of leakage is that it may substantially negate California's efforts.

At the outset, we also wish to emphasize that the term leakage is an unfortunate one. While it captures the concern that efforts within California may be undone by the response of the broader economy, it also unfortunately and inaccurately seems to suggest that California will attempt to reach out beyond its borders or that it will somehow target "trouble makers" outside of the state. Instead, a better way to think of anti-leakage measures is that they are devices to plug holes in California's regulatory program to prevent the benefits of that program from dissipating. So long as these measures are applied evenhandedly and without discriminatory effects on economic activity outside the state, they are appropriate measures for a state to enact. This document examines a number of ways that California might address leakage by focusing exclusively within itself. As discussed below, the more that California looks outward or aims its program at outsiders, the more likely it is that the dormant Commerce Clause will cause problems. In contrast, the more California concentrates inside its borders, the more likely it is that California's actions could withstand a dormant Commerce Clause challenge.

A. The Problem of Leakage in the Electricity Sector

We will focus our discussion below primarily on the dynamics of the electricity sector. Of all the sectors that a cap-and-trade program will likely cover, the electricity sector faces the greatest challenges in curbing leakage for several

reasons. First, the specific characteristics of the sector make it prone to leakage: electricity transmission lines make transporting electricity simple and inexpensive; prominent methods used to produce electricity—burning large amounts of coal or gas—are carbon-intensive processes; electrons on the grid are indistinguishable from each other; and many out-of-state production facilities have excess capacity, meaning opportunities to shift output abound.

The second reason that the electricity sector faces acute challenges from leakage relates to California's existing reliance on pollution-intensive electricity produced outside California. California currently purchases about one-quarter of its electricity from outside its borders. However, because California's electricity production facilities largely rely on sources of power other than coal and gas, the imported power accounts for one-half of the GHG emissions attributable to California's electricity use.¹¹ Thus, if California increasingly comes to rely on electricity produced outside of California, it seems plausible that the out-of-state energy may be dirtier than that produced within California.

Below, we briefly explain how California's options in controlling leakage from its cap-and-trade system implicate the Constitution. First, we discuss the state's objectives and how leakage impacts those objectives. Next, we describe the legal structure of the dormant Commerce Clause. We then examine how the dormant Commerce Clause implicates California's decision, focusing on the import of expressing and remaining true to the state's purpose of enacting GHG regulations.

1. Program Objectives

In evaluating California's cap-and-trade program with the dormant Commerce Clause in mind, the constitutionality of any government action that implicates interstate commerce will in large part turn on its objectives and whether the provisions of California's cap-and-trade program can be defended as an effective means of achieving those objectives. The state's basic objectives for the program were defined by the California Legislature in AB 32:

The Legislature finds and declares all of the following:

(a) Global warming poses a serious threat to the economic well-being, public health, natural resources, and the environment of California. The potential adverse impacts of global warming include the exacerbation of air quality problems, a reduction in . . . the Sierra snowpack, a rise in sea levels . . . , damage to marine ecosystems and the natural environment, and an increase in . . . human health-related problems.

(b) Global warming will have detrimental effects on some of California's largest industries. . . . It will also increase the strain on electricity supplies. . . .

(c) California has long been a national and international leader on energy conservation and environmental stewardship efforts. . . . The program established by this division will continue this tradition. . . .

11. CENTER FOR CLEAN AIR POLICY, POLICY OPTIONS FOR REDUCING GREENHOUSE GAS EMISSIONS FROM POWER IMPORTS (2005) (CEC-600-2005-010), available at <http://www.energy.ca.gov/2005publications/CEC-600-2005-010/CEC-600-2005-010-D.PDF> (draft consultant report prepared for the California Energy Commission using data from EPA eGRID, 2000).

(d) National and international actions are necessary to fully address the issue of global warming. However, action taken by California to reduce emissions of greenhouse gases will have far-reaching effects

(e) By exercising a global leadership role, California will also position its economy . . . to benefit from . . . efforts to reduce emissions of greenhouse gases . . . and will provide an opportunity for the state to take a . . . leadership role in reducing emissions of greenhouse gases.¹²

These rationales contrast starkly to the thrust of the concerns behind the dormant Commerce Clause, which relate to economic protectionism. Rather than protecting its internal economy, California aims to lead the way in taking actions that will help the world reduce the threat of climate change.

2. Leakage in Light of California's Program Objectives

To understand why California is justified in worrying about leakage, it is useful to think about how leakage implicates California's stated purposes in enacting AB 32. Put into the context of energy production and consumption, California's purposes boil down to three recurring themes:

- Taking responsibility for emissions caused by the energy it produces and consumes;
- Reducing externalities related to its production and consumption of energy; and
- Showing leadership as an environmental steward.

Leakage relates to each of these themes.

Leakage directly undermines all three of these primary objectives. California wants to take responsibility for the emissions that it produces and consumes—what is sometimes called the state's global warming footprint. Leakage makes it much more difficult for California to do so. If in response to California's regulation a producer stops generating electricity in-state only to increase its generation outside the state, California will not have reduced its global warming footprint: consumption in California will be just as responsible for the GHGs being generated outside the state as it would be if production came from a California-located power plant. Depending on the way the in-state and out-of-state electricity are produced, this may even result in a net increase in GHG emissions. Similarly, leakage undercuts the objective of reducing for the benefits of California citizens the global warming externalities associated with its consumption and production of electricity. Regardless of where they are released, GHGs contribute equally to the global warming problem. Displacing California emissions with emissions outside the state leaves the global warming problem unaffected or worsened. Finally, it is hard for California to show environmental leadership if leakages make California's regulatory structure ineffective.

California has a compelling argument that it has the authority to design a cap-and-trade system sufficient to meet its goals. Yet, at the same time, the Constitution limits how California may go about negating the adverse effects of leakage. Just as a municipal police chief could not investigate and arrest drug dealers who have moved out of the police chief's municipality and started up business somewhere

else, states face limits in what they can do to minimize the adverse effects of leakage. So long as the cap-and-trade program places legal responsibilities on entities that remain in California or on sales of electricity to users in California, and so long as it does not place burdens on the entities or transactions that differ according to whether the electricity involved was generated inside or outside the state, its efforts have a good chance of being sustained. The next section reviews the Supreme Court case law that supports these conclusions. The first two subsections describe the existing Supreme Court doctrine. The third subsection applies these doctrinal principles to different approaches to the regulation of GHGs.

B. Dormant Commerce Clause

The dormant Commerce Clause is a constitutional principle not actually mentioned in the text of the Constitution. Under the Constitution, the U.S. Congress has the power to regulate interstate commerce. The dormant Commerce Clause is an unwritten logical extension of Congress' power (hence, it is "dormant") that prevents states from usurping Congress' authority to regulate interstate commerce.

At the heart of the dormant Commerce Clause is the principle that states are not allowed to discriminate against citizens of other states "simply to give a competitive advantage to in-state businesses."¹³ The concern that states had erected trade barriers among them

reflect[s] a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the [s]tates under the Articles of Confederation.¹⁴

Undoubtedly, the free flow of commerce among the states is one of the chief assets of U.S. economic strength.

In reviewing dormant Commerce Clause challenges, courts first look to whether the law discriminates against out-of-staters or attempts to regulate beyond a state's jurisdiction. If a law does either of these, courts apply a strict scrutiny standard which is extremely difficult for a state to satisfy.¹⁵ If a law regulates evenhandedly and only attempts to regulate within its borders, it still receives dormant Commerce Clause scrutiny, but the courts apply a balancing test that is much more favorable to the state law.¹⁶

If a state law receives strict scrutiny, it is subject to a "virtually per se rule of invalidity."¹⁷ Few laws—exactly one, in fact—have survived the strict scrutiny that the Court applies to discriminatory laws. Under the balancing test that courts apply to evenhanded laws—sometimes called the *Pike* balancing test (see case mentioned below)—laws have much greater chances for success. In all cases, courts exam-

13. *Granholm v. Heald*, 544 U.S. 460, 472 (2005).

14. *Id.* (citing *Hughes v. Oklahoma*, 441 U.S. 322, 325-26, 9 ELR 20360 (1979)); see also *THE FEDERALIST* No. 22 (Alexander Hamilton) (discussing how the Constitution would prevent local protectionism and trade barriers resulting from states seeking retaliation for another state's trade barriers).

15. *Healy v. Beer Inst.*, 491 U.S. 324, 336-37 (1989).

16. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

17. *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978).

12. CAL. HEALTH & SAFETY CODE §38501 (in part).

ine the law, the information before the state when it made the law (the record), and the real-world impact of the law.

1. Strict Scrutiny

The first order question for dormant Commerce Clause analysis is what level of scrutiny a court should apply. In order to ferret out a law that burdens interstate commerce, courts first look to whether a state regulation is discriminatory.

Discriminatory laws fall into two categories: (1) facially discriminatory laws; and (2) facially neutral laws.¹⁸ Facially discriminatory laws are those that differentiate between in-state and out-of-state entities in terms of the laws themselves. Facially neutral laws do not draw a distinction in terms of the law between in-state and out-of-state entities, but they are found to be discriminatory either because of their effects or their purposes.

If a law is facially neutral, a court will review a law based on its impacts on interstate commerce.¹⁹ Whether a court deems a facially neutral state law discriminatory or neutral in application largely depends on how the court characterizes the law's application. Here, courts should focus primarily on the law's practical effect, although a discriminatory purpose can also subject a law to strict scrutiny.²⁰ If a facially neutral law does not create barriers to trade, prohibit the flow or increase the costs of interstate commerce, or distinguish between in-staters and out-of-staters, courts will deem a law nondiscriminatory.²¹

Although strict scrutiny is usually reserved for discriminatory laws, there is also the special case of laws that attempt to "control conduct beyond the boundary of the state," or extraterritorial legislation.²² Again, courts will look to see if a law explicitly is extraterritorial or has the "practical effect" of being extraterritorial. In evaluating whether a law has the practical effect of regulating conduct beyond state boundaries, courts consider the consequences of the law, how the challenged law interacts with other states' regulations, and what would happen if many or all states adopted similar legislation.²³ After weighing these specific considerations, if the court finds that a state regulation would produce "inconsistent legislation," it will apply strict scrutiny and consistently strike down such laws.²⁴

Once a court determines that it should apply strict scrutiny, what does this mean? From a pragmatic approach, it means that the state will almost certainly lose. The Court has upheld only one state law that was deemed to be a discriminatory state law²⁵ and no state law that attempts to control conduct beyond the state's boundaries.

From a more doctrinal perspective, in order to uphold a discriminatory or extraterritorial law, courts must find that

the law has a legitimate and substantial purpose and that there are no less discriminatory means of accomplishing that purpose. While courts look critically at both prongs, the burden of showing that there are no less discriminatory means is an especially heavy one.²⁶ If a court finds that there is any potentially less discriminatory way for a state to accomplish its purposes, the court will require the state to pursue this method.²⁷ Litigants and courts have proven to be very capable of finding less discriminatory means.²⁸ As Justice Thurgood Marshall famously explained in another context: "[S]trict scrutiny is strict in theory but fatal in fact."²⁹ While that aphorism has not held true in the context of equal protection jurisprudence,³⁰ it remains true in the context of the dormant Commerce Clause.

2. Pike Balancing Test

When a state law is not discriminatory or extraterritorial, courts apply a balancing test. The Supreme Court articulated the standard for a balancing test for dormant Commerce Clause challenges in *Pike v. Bruce Church, Inc.*³¹: "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."³²

The *Pike* test requires courts to make a number of relatively subjective evaluations: (1) whether the claimed local interest is "legitimate"; (2) whether any "less burdensome" regulatory alternatives are available; and, ultimately, (3) whether the alleged benefits of the regulation outweigh the burdens on interstate commerce.³³ Because of the subjective nature of this test, the outcome of the test is often difficult to predict.³⁴

The Supreme Court has found that protecting the business reputation of in-state producers is a fairly insignificant interest.³⁵ In contrast, the Court has found a wide range of purposes to be legitimate including public safety,³⁶ con-

18. *Hunt v. Washington St. Apple Adver. Comm'n*, 432 U.S. 333, 350-53 (1977).

19. *Id.* at 353.

20. *See, e.g., id.*; *West Lynn Creamery v. Healy*, 512 U.S. 186 (1994); *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 11 ELR 20070 (1981); *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978).

21. *Hunt*, 432 U.S. at 353.

22. *Healy*, 491 U.S. at 336-37.

23. *Southern Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 775 (1945).

24. *See id.*

25. *Maine v. Taylor*, 477 U.S. 131 (1986).

26. *See, e.g., Hughes v. Oklahoma*, 441 U.S. 322, 9 ELR 20360 (1979) (involving facial discrimination forbidding export of minnows, which "by itself may be a fatal defect, regardless of the State's purpose").

27. *See id.*

28. *Granholt v. Heald*, 544 U.S. 460 (2005) (holding that a law prohibiting the selling of wine directly to out-of-staters over the Internet to avoid under-age drinking was "mere speculation" and too tenuous); *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951) (suggesting the use of national standards or expanding city inspections to achieve health-motivated regulation).

29. *Regents of Univ. of Cal. v. Bakke*, 438 U.S. 265, 363 (1978) (Marshall, J., concurring in part and dissenting in part).

30. *See, e.g., Grutter v. Bollinger* 539 U.S. 306, 326 (2003) (observing that "[s]trict scrutiny is not 'strict in theory, but fatal in fact'" while upholding the University of Michigan Law School's affirmative action admissions program against an application of strict scrutiny).

31. 397 U.S. 137 (1970).

32. *Id.* at 142.

33. *Id.*

34. *Camps Newfound, Inc. v. Town of Harrison*, 520 U.S. 564, 610-12 (1997) (Thomas, J., joined by Rehnquist, C.J., & Scalia, J., dissenting) (going so far as to call application of the dormant Commerce Clause "tangled underbrush" and "virtually unworkable in practice").

35. *Pike*, 397 U.S. at 145.

36. *Id.* at 146.

sumer protection,³⁷ resource conservation, and environmental quality.³⁸ While courts have found many purposes legitimate, states should cast a wide net to justify their regulations. Some interests may receive more weight than others. For example, while the Supreme Court has recognized environmental protection as a legitimate local interest, it has done so on limited occasions and seems to prefer such interests be articulated in terms of public safety. This may particularly be the case with the current makeup of the Supreme Court.

In the Supreme Court's most recent environmental decision, *Massachusetts v. EPA*,³⁹ four dissenting Justices would find that the state challengers did not have standing to sue over harm caused by climate change⁴⁰ and would allow the U.S. Environmental Protection Agency (EPA) to reject GHGs as pollutants under the Clean Air Act.⁴¹ Similarly, in *Rapanos v. United States*,⁴² the same four Justices dissented and read the Clean Water Act in a way that would strip it of much of the environmental protection currently provided under the Act. Taken together, it seems wise to frame the threats of climate change more broadly than environmental problems. Indeed, this is what the California Legislature did in laying out its purposes for enacting AB 32.

While we suggest that states should cast a fairly wide net in framing their purpose, states need to understand that overstating the case may prove harmful in the course of litigation. One reason for this is that it is critical that a state build a robust record justifying the state's purposes for action. Hollow reasons for action will make it difficult to build an adequate record. States should take time to draw a clear relationship between the state regulation and the harm it seeks to prevent. Additionally, it hurts states to concoct rationales out of thin air, because in parsing a state's purpose, courts are often skeptical about a state's purported interests. The main concern underlying this is that any stated reasons may actually be merely dressed up rationales that cloak economic protectionism. Our assessment is that the stated purposes for enacting AB 32 are substantial and justifiable rationales for regulatory action. California should attempt to back up these rationales with an administrative record that shows a clear connection between the regulatory measures it chooses and the purposes set forth by the legislature.

3. Application

If California aims to stop leakage by treating electricity generated outside of California differently than electricity generated inside California, the state will almost certainly lose when facing a lawsuit based on dormant Commerce Clause grounds. This means that California should avoid making policy distinctions between in-state energy and out-of-state energy and create a process that is blind to the location of energy production. Similarly, if California attempts to stop leakage by attempting to regulate outside of California, the state will likely lose. This means that the incidence of regu-

lation—the events upon which regulatory requirements are imposed—ought to be easily describable as occurring within California. For example, California might be tempted to require those generating energy to install costly equipment to monitor emissions. Imposing this burden outside of the state might invite the argument that California is regulating beyond its boundaries. In contrast, California might require that anyone selling electricity in the state of California be able to provide assurance that certain GHG-related standards are being met. Such assurance might be provided by continuous emissions monitors, but these would not have been directly mandated.

Given the stringency of the strict scrutiny test, California's only viable option is to regulate in such a way that courts will apply the *Pike* balancing test, or in other words, to create laws that do not discriminate or have extraterritorial effects.

With regard to the first prong of the balancing test, a reviewing court will evaluate California's legitimate interests in enacting a GHG cap-and-trade program. California's interests as well as how those interests are served by the measures it is taking should be substantiated by a record of evidence. Assuming that California builds a proper record to support its decision, a reviewing court should find that California's interests are substantial. However, California can help a potential reviewing court see the policy in its most favorable light. To do so, California will want to highlight those factors that receive greater recognition from reviewing courts.

With the justifications California has already laid out in AB 32,⁴³ the state has started out on the right foot. In moving forward, we suggest that California keep four principles in mind when crafting its regulations. First, California should create a process and rationale for action that focuses on regulating California. Not only should California document its desire to regulate its own internal consumption and production of GHGs, its actions should back this up. This means finding ways to run its program—including its attempt to control leakage—by focusing on actors operating within the state. This is discussed in a little more detail below when discussing the burden prong of the *Pike* analysis.

Second, California should identify and stress the benefits that accrue specifically to California. Even though California is attempting to lessen the impact of a global problem, California's strongest justification for taking state action is that this global problem has severe localized impacts on the state. California's record should explain how the actions that it takes are aimed at helping the state and should describe the local factors at risk. Again, the groundwork for this approach is already in place in the legislative purposes found in AB 32.⁴⁴

In a related vein, California should anticipate the argument that its efforts are futile. In other words, opponents in litigation might argue that regardless of what California does, it will suffer the harm it seeks to avoid. In passing AB 32, California has emphasized its desire to show environmental leadership.⁴⁵ Its desire to inspire others to act is important. California should also make the case that the only way to solve international problems is for many to do their

37. *Id.*

38. *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 11 ELR 20070 (1981).

39. 127 S. Ct. 1438, 37 ELR 20075 (2007).

40. *Id.* (Roberts, C.J., dissenting).

41. *Id.* (Scalia, J., dissenting).

42. 126 S. Ct. 2208, 36 ELR 20116 (2006).

43. *See supra* Part I.A.1.

44. *Id.*

45. *See CAL. HEALTH & SAFETY CODE* §38501(c).

part. If every government had to wait for the world to agree before taking action, nothing would be done. California's efforts to reduce the challenge make others more likely to act.

Third, California needs to take special pains to avoid even the appearance that its program is motivated by punishing out-of-staters. While we have no reason to anticipate that this would be any part of California's motives, the record ought to reflect clearly that California is solely interested in taking responsibility for its share of the global warming problem, and not out of any desire to go after out-of-state "bad guys." If such motivation became an important element in California's decision, even if only because rhetorically it is a way to generate in-state support, this will put the state on much less solid ground.

Fourth, in crafting its policy, California should avoid indicting the federal government for its lack of action. California should take care not to frame its efforts as an attempt to override federal politics on GHG regulation.⁴⁶ While California can legitimately note that it is dissatisfied with national policies, it needs to walk a fine line so that it does not appear that the overriding motivation for California's action is to put a stick in the eye of the federal government.

With regard to the second prong of the *Pike* balancing test, a reviewing court will weigh California's benefit against the burden its policies place on interstate commerce. Again, California can assist itself by intelligently designing its regulatory system. While it is impossible to assess the burden of an unknown program, we do wish to provide two benchmarks that would lessen the impact on the interstate economy.

One benchmark policymakers should keep in mind is the more squarely that California can place the regulatory burden on in-state actors the better. For example, California could place its burden on load-serving entities that transport electricity within the state, utilities that generate or sell electricity within the state, or consumers that consume within the state. Of course, in making its decision, California will want to reduce leakage, and it will somehow need to track both the energy produced outside the state but sold in California along with the electricity produced in California but exported elsewhere.

A second benchmark is that the simpler California makes it for out-of-staters to comply with the state's regulations, the better. The more burdensome the regulation, the more likely it is that a court will find that the state failed the *Pike* balancing test. This is important enough that it is not unreasonable for the state to seriously consider making small concessions of the program's effectiveness in order to accommodate this goal. Similarly, California will also want to make sure that its policy will place out-of-staters that want to participate in California's market on equal footing with in-staters. The theme should be that out-of-staters are only asked to do their fair share and that the burdens and processes that out-of-staters encounter are no different from those of in-state producers.

In sum, we think that California's legislation will survive a legal challenge under the dormant Commerce Clause if it avoids strict scrutiny, attaches regulatory obligations on events that can readily be described as in-state activities, and compiles a record documenting the effectiveness of its regu-

latory measures in accomplishing the state's legitimate objectives. That said, California can do much to help its cause in the instance that a reviewing court weighs California's regulation under the *Pike* balancing test. Climate change looms large in California's future, as it does for the entire world. To build a strong record, California needs to tie its actions and explain its policies in light of those threats. Additionally, it should avoid vilifying out-of-state interests or the federal government.

As far as the burden prong of the *Pike* analysis goes, California should focus as much as possible on placing the compliance burdens of regulations on in-state actors. We suggest, for example, that California do this by focusing on load-serving entities, in-state utilities that buy and sell power, or on in-state consumers and generators of electricity. Additionally, the state will help its cause if it makes it easy to comply with its regulations and takes pains to assure that out-of-staters do not have different burdens or have to comply with different processes than those required of in-staters.

The key to surviving a reviewing court's analysis of the *Pike* balancing test, however, is to focus on California as much as possible. This is true as California lays out the purposes of its program and as it determines where to place the burden of regulations. While the import of California's actions is easy to dramatize, this should not blur the policy-makers' realization that it is prudence that will win the day. And, in fact, if California regulates in an evenhanded way and takes the necessary pains to justify its actions, we believe that the state can withstand a dormant Commerce Clause challenge.

II. Emissions Trading and Dormant Foreign Policy Power

In addition to leakage issues and the dormant Commerce Clause, California needs to remain aware of another federal constitutional matter. California has taken steps to initiate linkages between its own future cap-and-trade program and trading systems of foreign governments, which may implicate the dormant foreign relations power.

In particular, on July 31, 2006, Governor Schwarzenegger and Prime Minister Blair announced they had come to an agreement to make California and the United Kingdom partners in the war against global warming. As a result of the agreement, California and the United Kingdom will share best practices on market-based systems to reduce GHGs. They will also cooperate to investigate new technologies to control GHGs into the future. The agreement has been heralded as a beachhead for those who hope to reduce GHGs and as a first step toward the growth of an efficient GHG trading market that would link California's market with the EU. Additionally, just this year, Governor Schwarzenegger has entered into similar agreements with the State of Victoria in Australia, as well as British Columbia, Ontario, and Manitoba.

In all the fanfare, the legal implications of such international connections have received little attention. In particular, the question remains whether the Constitution would even allow California to enter into an agreement regarding GHG regulation with another foreign nation. Such a system might implicate the dormant foreign relations power, a legal principle which holds that the federal government is the ulti-

46. See *infra* Part II.

mate authority with respect to U.S. foreign policy. In essence, the dormant foreign relations power attempts to assure that states do not pass laws that supplant federal foreign policy or that somehow interfere with the ability of the United States to speak to foreign nations with a single, clear voice.

Even though the federal government has declined to take action against global warming explicitly, California may still be precluded from taking such action on its own under the Constitution's dormant foreign relations power. This is a possibility, because an agreement between California and other foreign nations arguably undermines the foreign policy of the federal government.

A. *Extra-Jurisdictional Trading*

As California considers adopting a cap-and-trade program, one issue it will have to consider is what types of trading it will allow. A key question in this regard is the extent to which the system will issue credits for offsets made outside of California. In considering this question, California will likely have to balance the purposes of its program. On one hand, allowing extra-jurisdictional offsets provides opportunities for California to lower the cost of reducing emissions; larger markets generally increase diversity, which would lead to increased reductions and a more economically efficient program. On the other hand, extra-jurisdictional offsets reduce the incentives for California to reform its own dependence on GHG emissions. Extra-jurisdictional offsets are also more difficult to monitor effectively, which decreases certainty that claimed reductions are actual reductions.

Particularly in light of concerns regarding monitoring, California may consider limiting offsets to other states and even foreign governments that have reliable GHG markets in place. For example, California could limit its program to those states that have joined with California—at least in principle—to create the Western Regional Climate Action Initiative or perhaps expand its reach to the several northeastern and mid-Atlantic states that presently are developing a regional strategy to reduce carbon dioxide emissions, known as the Regional Greenhouse Gas Initiative (RGGI). If California could allow entities in its program to trade with other states, it is likely that this larger domestic market would benefit both California and the other states by providing more opportunities for low-cost reductions and more stability in trading markets.

California may also decide to look outside of the United States. International cooperation to reduce GHG emissions has already begun to take place. In 1992, 180 countries signed the United Nations Framework Convention on Climate Change (UNFCCC).⁴⁷ Negotiations under the UNFCCC led to the Kyoto Protocol, which was signed in 1997 and ratified in 2005, requiring Member nations to achieve an averaged 5.2% reduction in 1990 GHG levels by 2012.⁴⁸ In order to meet these requirements, the EU has recently initiated the largest GHG trading market in the world,

the EU's emissions trading scheme (EU-ETS), covering 25 countries and 6 major industrial sectors.⁴⁹ California may find great program savings if it honored offsets in the EU-ETS market (beyond that required by Kyoto) to count toward California's program. Furthermore, the agreement that Governor Schwarzenegger and Prime Minister Blair signed in July 2006 and those signed with other jurisdictions subsequently hint that California is seriously considering a market-based cap-and-trade program to reduce GHGs, which could potentially be linked to the EU-ETS or to other carbon markets outside the United States.⁵⁰

At this point, it is only speculation whether the EU-ETS or other foreign carbon markets would incorporate outside actors—particularly those governments that are part of a nation that has not ratified the Kyoto Protocol, such as a U.S. state. The EU-ETS, however, does allow Members to the EU-ETS to participate in international emissions trading with any Party included in Annex B of the Kyoto Protocol.⁵¹ Annex B includes the United States, so the EU could potentially link with individual U.S. states as subsidiaries of an Annex B nation.⁵² Again, it is at least plausible that California and the EU nations could benefit from such an international partnership.⁵³

49. *Id.* at 3-4 (“Simply stated, the EU-ETS dwarfs all existing early [greenhouse gas] GHG trading systems as well as the U.S. programs designed to control sulfur dioxide (SO₂) under the Clean Air Act Amendments and nitrogen oxides (NO_x) under the NO_x Ozone Transport Commission.”); *see also* Council Directive 2003/87, 2003 O.J. (L 275) 32 (EC), *available at* http://eur-lex.europa.eu/LexUriServ/site/en/oj/2003/l_275/l_27520031025en00320046.pdf.

50. *See* Press Release, Office of the Governor, Governor Schwarzenegger Signs Agreement With British Columbia Premier Campbell to Fight Global Warming (May 31, 2007), *available at* <http://gov.ca.gov/index.php?press-release/6521/>; Press Release, Office of the Governor, Governor Schwarzenegger Joins Ontario Premier McGuinty in Signing Pact to Fight Greenhouse Gases (May 30, 2007), *available at* <http://gov.ca.gov/index.php?press-release/6476/>; Press Release, Office of the Governor, Governor Schwarzenegger Collaborates With Premier Steve Bracks and the Australian State of Victoria to Fight Climate Change (May 4, 2007), *available at* <http://gov.ca.gov/index.php?press-release/6138/>; Press Release, Office of the Governor, Gov. Schwarzenegger, Premier of Manitoba, Canada Sign Agreement to Explore Linking of Future Carbon Trading Markets and Reduce Global Greenhouse Gas Emissions (Dec. 14, 2006), *available at* <http://gov.ca.gov/index.php?press-release/4920/>; Press Release, Office of the Governor, Gov. Schwarzenegger, British Prime Minister Tony Blair Sign Historic Agreement to Collaborate on Climate Change, Clean Energy (July 31, 2006), *available at* <http://gov.ca.gov/index.php/press-release/2770/>; *see also* Charles J. Hanley, *U.S. States Group Seeks Global-Warming Action*, PHILA. INQUIRER, Dec. 17, 2004, at A31 (discussing the possibility of the EU trading with states in the United States).

51. Council Directive 2003/87, *supra* note 49, at 33; *see also* Council Directive 2004/101, 2004 O.J. (L 338) 18, 20 (EC) (discussing the possibility of recognizing allowances from the EC within Annex B countries that have not ratified the Kyoto Protocol). It may be, however, that a trading scheme between the EU and U.S. states can only operate in one direction if credits from non-Party nations like the United States cannot be used for compliance in the EU under Kyoto. This would mean U.S. businesses could gain cheap allowances from the EU without making major reductions in emissions within the United States. Kirsten Engel, *Mitigating Global Climate Change in the United States: A Regional Approach*, 14 N.Y.U. ENVTL. L.J. 54, 82 (2005).

52. UNFCCC, *Kyoto Protocol: Background*, http://unfccc.int/kyoto_protocol/background/items/3145.php (last visited June 20, 2007).

53. Engel, *supra* note 51, at 80 (“The states involved in developing a regional greenhouse gas emissions trading market in the United States have discussed, with EU representatives, the possibility of linking their two emissions trading schemes.”); *see also* Hanley, *supra* note 50.

47. PEW CTR. ON GLOBAL CLIMATE CHANGE, THE EUROPEAN UNION EMISSIONS TRADING SCHEME (EU-ETS): INSIGHTS AND OPPORTUNITIES 2 (2006), *available at* <http://www.pewclimate.org/document.cfm?documentID=440> [hereinafter EU-ETS TRADING SCHEME].

48. *Id.*

If the California Air Resources Board decides to adopt a cap-and-trade program to reduce GHGs that is linked to the EU-ETS or some other foreign carbon market, there might be significant legal implications. We focus our analysis here on constitutional questions that surround such a trading scheme. Typically, foreign relations powers are vested in the federal government. State statutes that officially recognize foreign emissions credits may be preempted by federal action.

B. Dormant Foreign Relations Power

Clause 3 in Article I, §8 of the Constitution provides Congress the power to “regulate Commerce with foreign Nations.”⁵⁴ The Court has read the Constitution to mean that the federal government has authority to conduct foreign relations.⁵⁵ Furthermore, under the Constitution, the president has extensive foreign relations powers⁵⁶ and speaks with the country’s supreme voice on foreign policy.⁵⁷ The president has the authority not only to enter into treaties with the advice and consent of the Senate.⁵⁸

All this is not to say that a state government does not have any way to engage in agreements with international partners or to conduct business with firms from other nations. Rather, it means that any state cannot interfere with the federal government’s ability to create foreign policy—in other words, federal statutes dealing with foreign affairs, international treaties, and federal executive agreements preempt state regulations that interfere with them.⁵⁹

Article VI states that federal law, including treaties, is the “supreme Law of the Land.”⁶⁰ Sensibly, this provision is generally understood to mean that state laws that conflict with federal action must yield to federal power. The preemption of state laws can be either express or implied. Express preemption occurs when a federal statute explicitly says a state may not pass a law addressing a particular issue. Alter-

natively, implied preemption can occur in three different ways. First, a state statute can be preempted if it invades a field of federal law that is “so pervasive”⁶¹ that there is no room for state regulation. This first type of implied preemption is called “field preemption.”⁶² Second, a state statute that is in direct conflict with federal law is preempted.⁶³ Finally, a state statute that “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress”⁶⁴ can also be preempted.

Because foreign relations seem quintessentially a federal issue, the Court views state intrusion into foreign relations with a skeptical eye. At times, the Court has interpreted the field of foreign policy to be so broad that some state statutes which conflict with federal diplomacy have been deemed preempted without contradicting specific foreign agreements. This type of preemption could be seen as field preemption, but in the specific context of foreign policy has been dubbed the “dormant foreign relations power.”⁶⁵ While the Court has employed it sparsely, this broad power has been used to preempt state laws even if there is not an express treaty on the matter, even if the state law is not in direct conflict with foreign treaties, and even if the state law does not impede federal objectives directly. Basically, a state statute can be preempted regardless of whether the federal government has already acted through statute, treaty, or executive agreement.

Undercurrents of a dormant foreign relations power first surfaced in the case *Zschernig v. Miller*.⁶⁶ In that case, the Court evaluated an Oregon probate statute that allowed foreign nationals to inherit property in Oregon only if their country of citizenship recognized a reciprocal right for American citizens to inherit property and only if there was proof that the country of the foreign national would not confiscate the property in question.⁶⁷ Even though the statute did not directly conflict with federal law or treaties, the Court concluded it was “an intrusion by the State into the field of foreign affairs which the Constitution entrusts to the President and the Congress.”⁶⁸

The *Zschernig* Court cited decisions in Oregon and other states where courts had conducted inquiries into foreign law and investigations into foreign diplomacy in a manner likely to be found offensive by the countries involved, and found “[t]he practice of state courts in withholding remittances to legatees residing in Communist countries or in preventing them from assigning them [was] notorious.”⁶⁹ As a result, the Oregon law had affected “international relations in a persistent and subtle way.”⁷⁰ The Court con-

54. U.S. CONST. art. I, §8, cl. 3.

55. *American Ins. Ass’n v. Garamendi*, 539 U.S. 396, 414 (2003) (“If we are to be one nation in any respect, it clearly ought to be in respect to other nations.” (quoting THE FEDERALIST NO. 42, at 279 (James Madison) (J. Cooke ed. 1961))); *Japan Line, Ltd. v. City of Los Angeles*, 441 U.S. 434, 449 (1979) (“Foreign commerce is preeminently a matter of national concern. . . . Although the Constitution, Art. I, §8, cl. 3, grants Congress power to regulate commerce ‘with foreign Nations’ and ‘among the several States’ in parallel phrases, there is evidence that the Founders intended the scope of the foreign commerce power to be the greater.”).

56. *Garamendi*, 539 U.S. at 414 (“The President . . . possesses in his own right certain powers conferred by the Constitution on him as Commander-in-Chief and as the Nation’s organ in foreign affairs.” (quoting *Chicago & S. Air Lines v. Waterman S.S. Corp.*, 333 U.S. 103, 109 (1948))); *United States v. Curtiss-Wright Corp.*, 299 U.S. 304, 319-22 (1936) (stating in the realm of foreign affairs, “the President alone has the power to speak or listen as a representative of the nation”).

57. *See Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 610-11, 635-36 (1952); *see also First Nat. City Bank v. Banco Nacional de Cuba*, 406 U.S. 759, 767 (1972).

58. *See, e.g., Dames & Moore v. Regan*, 453 U.S. 654 (1981) (recognizing that the formation of the Iran-United States Claims Tribunal as a forum to arbitrate against Iran preempted any state litigation on the matter); *United States v. Pink*, 315 U.S. 203, 223, 230 (1942); *United States v. Belmont*, 301 U.S. 324, 330-31 (1937) (recognizing the Litvinov Agreement preempted state policy on whether to recognize a claims assignment from the Soviet Union to the United States).

59. *See, e.g., U.S. CONST. art. VI; Crosby v. National Foreign Trade Council*, 530 U.S. 363 (2000).

60. U.S. CONST. art. VI.

61. *Gade v. National Solid Wastes Mgmt. Ass’n*, 505 U.S. 88, 98, 22 ELR 21073 (1992) (quoting *Rice v. Santa Fe Elev. Corp.*, 331 U.S. 218, 230 (1947)).

62. *Id.* at 98.

63. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963).

64. *Gade*, 505 U.S. at 98 (citing *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941), *Felder v. Casey*, 487 U.S. 131, 138 (1988), and *Perez v. Campbell*, 402 U.S. 637, 649 (1971)).

65. Brannon P. Denning, *International Decision*, 97 AMER. J. INT’L L. 950, 958 (2003).

66. 389 U.S. 429 (1968).

67. *Id.* at 431.

68. *Id.* at 432.

69. *Id.* at 440.

70. *Id.*

cluded that the Oregon law impacted foreign relations with the potential to affect adversely the power of the federal government to interact with some countries.⁷¹ In so concluding, it developed a direct effects test which meant state statutes directly affecting foreign policy in a negative way would be preempted.⁷²

Since *Zschernig*, the Court has not often revisited the dormant foreign relations power. *American Insurance Ass'n v. Garamendi*⁷³ is the only other case in which the Court has expressly relied on the dormant foreign relations power to preempt state statute. *Garamendi* dealt with a California statute called the California's Holocaust Victim's Insurance Relief Act of 1999 (HVIRA), which required any insurance company dealing in California to disclose involvement those companies may have had with the insurance policies of Holocaust victims. California enacted HVIRA in order to allow Holocaust victims to gain redress for violations suffered during World War II, when Nazi officials had forced victims to relinquish or cash in their insurance policies.⁷⁴

American Insurance argued HVIRA intruded on executive agreements already established that created a foundation with funds to address Holocaust claims.⁷⁵ Those agreements stipulated any claims would be settled through a voluntary organization called the International Commission on Holocaust-Era Insurance Claims (ICHEIC), using monies from the foundation.⁷⁶ The majority of the Court agreed with American Insurance and relied heavily on *Zschernig* to find that the executive agreements preempted HVIRA.⁷⁷

In *Garamendi*, the Supreme Court set up a two-step analysis, the first step of which determined whether the state statute in question involved a traditional state interest. If a state law affecting foreign policy did not fall under traditional state competence, the Court suggested the state law should be preempted whether or not the federal government had already acted.⁷⁸ While the Court has yet to employ this type of preemption, it seems quite similar to that of the dormant Commerce Clause's strict scrutiny standard. If, a state law did address a topic of traditional state competence, as the regulation of insurance did, the Court held that state laws were to be reviewed under a balancing test. In such a circumstance, the Court explained that it would weigh the strength of the foreign policy interest against the importance of the state concern.⁷⁹ While this line of case law is far from completely developed, it appears to work very similarly to the balancing test used for dormant Commerce Clause challenges.

In evaluating HVIRA, the *Garamendi* Court concluded foreign policy interests outweighed state interests in the

matter of "vindicating victims" of war crimes.⁸⁰ The Court stated that HVIRA "compromises the very capacity of the President to speak for the Nation with one voice in dealing with other governments to resolve claims against European companies arising out of World War II."⁸¹ The Court went on to say that "[t]he basic fact is that California seeks to use an iron fist where the President has consistently chosen kid gloves."⁸² The Court found that the Constitution forbade California from using HVIRA because it compromised the president's diplomatic relations and on this basis struck down the law.

Even though the dormant foreign relations power itself sat idle in the Court's jurisprudence in the 35 years since *Zschernig*, the recent Court decision in *Garamendi* effectively revitalized the dormant foreign relations power. To be sure, states are usually not precluded from acting unless the federal government has directly spoken to an issue through statute or treaty, or unless the state action would directly conflict with federal action. But *Garamendi* illustrates a narrow exception to that general rule. In cases like *Garamendi*, state action can be preempted if it interferes with federal diplomatic efforts. As a result, California, or any other state, should take care when embarking on international agreements.

C. The Dormant Foreign Relations Power and California's Ability to Expand Its Market to Include Offsets Outside of the United States

Starting with the premise that states can act as long as the federal government has not acted, it would seem that states are not precluded from developing international trading agreements for GHG emissions. Although the federal government has expressed various positions on climate change through a number of different channels, none of them directly preempt California from incorporating offsets outside of the United States into its state program.

In 1997, the U.S. Senate approved a resolution that declared that the United States would not ratify any international agreement on climate change unless the agreement required adequate emission controls on developing countries and did not cause the United States economic harm.⁸³ President George W. Bush has stated that his Administration is opposed to the Kyoto Protocol because it does not include major carbon-producing countries, like China.⁸⁴ These statements address the deficiencies to Kyoto specifically. They only demonstrate that the federal government will not presently act to reduce GHGs under Kyoto. This does not mean that states are precluded from acting as a result. Presi-

71. *Id.* at 441.

72. *Id.*

73. 539 U.S. 396 (2003).

74. *Id.* at 401-12.

75. *Id.* at 413.

76. *Id.* at 401-12.

77. *Id.* at 401. Given that *Garamendi* was a 5-4 decision and that two of the Justices in the majority no longer serve on the Court, it is possible that the Court may see a *Garamendi* analysis somewhat differently today. However, even if a challenge was brought, it might take years to find its way to the Court—if it makes it at all—so vote-counting at this stage is overly speculative.

78. *Id.* at 420.

79. *Id.*

80. *Id.* at 421.

81. *Id.* at 424.

82. *Id.* at 427.

83. The Senate passed the bill unanimously. S. Res. 98, 105th Cong. (1997). The U.S. House of Representatives had a similar bill which died in committee. H.R. Res. 211, 105th Cong. (1997).

84. Letter from President George W. Bush to Senators Hagel, Helms, Craig, and Roberts, in 1 PUB. PAPERS 235 (Mar. 13, 2001), available at <http://www.whitehouse.gov/news/releases/2001/03/20010314.html>; OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, STATEMENT OF ADMINISTRATION POLICY (2003), available at <http://www.whitehouse.gov/omb/legislative/sap/108-1/s139sap-s.pdf> (characterizing the Kyoto Protocol as "an international climate change agreement inconsistent with the views of the U.S. Senate").

dent Bush also has entered into an executive agreement with Asian nations, called the Asia-Pacific Partnership on Clean Development and Climate, which focuses on encouraging the development of new technology that can reduce GHG emissions.⁸⁵ “The Partnership focuses on voluntary practical measures taken by these six countries in the Asia-Pacific region to create new investment opportunities, build local capacity, and remove barriers to the introduction of clean, more efficient technologies.”⁸⁶

Of the measures listed above, the Asia-Pacific Partnership is the only formal action that deals explicitly with federal government action on climate change. It is proper to ask whether this is preemption by an executive agreement. It does not appear that it is. The Asia-Pacific Partnership does not expressly preempt state law. In fact, the charter states that the partnership is meant to complement and not to replace the Kyoto Protocol, and that it will build on other global initiatives. Thus, it seems rather than prohibiting action, the partnership seeks to encourage other efforts to reduce GHG emissions.⁸⁷ Furthermore, given that the agreement focuses on developing clean technologies, rather than economic cap-and-trade programs, a state statute to initiate carbon trading with the EU is unlikely to directly conflict with or impede the partnership. So, it is not probable that the Asia-Pacific Partnership, alone, will preempt state initiatives related to GHG emissions.

It should be noted that Congress has recently been considering a number of bills to address climate change and doing so with increasing fervor, including the Lieberman-McCain Climate Stewardship Act of 2007.⁸⁸ If any of these bills are ratified, state cap-and-trade programs might be more directly preempted. For now, however, we are operating under the assumption that the federal government has not taken any direct action to establish a cap-and-trade program in the United States.

1. The *Garamendi* Exception

Because state carbon trading schemes are not explicitly preempted, to the extent that the federal government prohibits California from setting up a trading system that cooperates with foreign countries, it would have to be under the narrow exception of *Garamendi*, or the dormant foreign relations power. In fact, the Supreme Court in *Massachusetts v. EPA* suggested that a state’s ability to act on the international stage in this very context of climate change is limited:

When a State enters the Union, it surrenders certain sovereign prerogatives. Massachusetts cannot invade Rhode Island to force reductions in greenhouse gas emissions, it cannot negotiate an emissions treaty with China or India, and in some circumstances the exercise of its police powers to reduce in-state motor-vehicle emissions might well be pre-empted.⁸⁹

85. Statement on the Asia-Pacific Partnership on Clean Development and Climate, 41 WEEKLY COMP. PRES. DOC. 1226 (July 29, 2005).

86. BUREAU OF PUBLIC AFFAIRS, U.S. DEP’T OF STATE, ASIA-PACIFIC PARTNERSHIP ON CLEAN DEVELOPMENT AND CLIMATE (2006), available at <http://www.state.gov/documents/organization/60955.pdf>.

87. Charter for the Asia-Pacific Partnership on Clean Development and Climate, Jan. 11, 2006, available at <http://www.state.gov/g/oes/rls/or/2006/59162.htm>.

88. S. 280, 110th Cong. (2007).

89. *Massachusetts v. EPA*, 127 S. Ct. 1438, 1454, 37 ELR 20075 (2007).

The relevant question, then, is whether *Garamendi* can be distinguished from the case of an international agreement on GHG emissions reductions between California and the EU. Basically, if the California Air Resources Board is able to demonstrate how trading regulations do not fall within the *Garamendi* exception, those regulations will be more robust to potential constitutional challenges.

One difference between the insurance laws in *Garamendi*, as compared to a GHG trading market, is that the insurance laws implicated the president’s wartime power. In other words, when a state’s law implicates the president’s ability to broker peace, the executive’s dormant foreign relations power is particularly robust. In fact, the Court in *Garamendi* specifically noted that the executive would not normally have had as much power to regulate claims from private entities, but with regard to wartime claims, the public and the private sectors become blurred.⁹⁰ Accordingly, state initiatives aimed at resolving private liability claims would be much more durable absent the presence of the executive’s war power.⁹¹ In contrast to the laws at issue in *Garamendi*, California’s GHG regulations avoid compromising the president’s wartime authority.

A cap-and-trade market linking California with the EU would be aimed at facilitating private voluntary exchanges, not at resolving public international disputes. It is not as if California would be ratifying a formal policy with the EU on how to address climate change, but rather it would only serve to facilitate efficient trading markets. While it is true that public regulations would need to be in place in order to ensure an efficient trading scheme, the private market would be controlling the trades, rather than public negotiations. As a result, international diplomacy is not at stake in as precarious a way as it was in *Garamendi* or as in the illustrative example of initiating formal talks with China, as the Court described in *Massachusetts v. EPA*. It would be important for the California Air Resources Board to emphasize this distinction in its regulations and focus on the private rather than public aim of any negotiations that would include the EU.

Another difference between *Garamendi* and emissions trading markets is that emissions trading fits more easily within a traditional state interest. In *Garamendi*, the Court stated that California was not acting within a traditional state interest by enacting regulations directing insurance companies to disclose Holocaust-era insurance claims. As compared to the limited aim of redressing Holocaust victims in *Garamendi*, a GHG emissions trading scheme would have much broader relevance for the entire state.

In large part, just as governmental purpose established in the record will control the dormant Commerce Clause analysis, the record built by the California Air Resources Board during its decisionmaking process will fundamentally determine how a court would view California’s interest. It is not hard to imagine that in formulating regulations for a cap-and-trade system, one reason California might move forward is to make up for what might be viewed as the failure of the federal government to take any meaningful international action on climate change. Indeed, the fact that the federal government has not entered into the Kyoto Protocol might have great value as symbolic politics. The more that

90. *American Ins. Ass’n v. Garamendi*, 539 U.S. 396, 415-16 (2003).

91. *Id.*

California articulates an interest in trying to demonstrate the inadequacies of the federal approach, the more its own characterization suggests a desire to set up a conflict between federal policy and state policy—and the closer it gets to the dormant foreign affairs line.

Particularly problematic would be an effort by California to try to use its program to somehow reform the international trading system formed by Kyoto, perhaps by insisting on some change to its trading or processes before California would concede to reciprocity of emission credits. If this is the case, as suggested in *Massachusetts v. EPA*, California would have very weak footing. The Court has long recognized a prominent federal interest in foreign commerce, just as it has its interest in interstate commerce. For example in *Japan Line, Ltd. v. City of Los Angeles*,⁹² the Court struck down a state tax on Japanese shipping companies, stating, “foreign commerce is preeminently a matter of national concern.”⁹³ It would be wise for California to avoid renegotiating existing Kyoto conditions during any discussions.

Thus, California would be smart to build a strong record emphasizing the ways in which California would benefit from both its program and its desire to reduce costs of the program on its regulated community. While the particular method of establishing an international trading system may be a novel approach to minimizing the cost of exercising police power, the idea of both seeking efficiency and attempting to protect and look after its citizens is a very familiar one for state lawmakers.

The theme California may want to emphasize is that its trading scheme would increase environmental well-being by encouraging the reduction of GHGs while saving businesses money by allowing them to trade carbon credits in a larger market. In particular, it should make clear that linking state initiatives to the EU-ETS or other foreign carbon markets has the potential of making it easier for state businesses to comply with stringent emission caps because the EU-ETS is such a large and comprehensive market.⁹⁴

Both the private nature of emissions trading regulations that would include Europe and the fact that such regulations would align with traditional state interests serve to distinguish *Garamendi* from an emissions trading scheme. Yet, it may still be argued that the federal government has a federal interest to speak with one voice in continued negotiations and that if California were to incorporate international cooperation into its trading system, the United States would have less clout as a hold out. It could also be argued that establishing a trading initiative between foreign governments and U.S. states would interfere with the Administration’s protests against the Kyoto Protocol. The argument may go that if Kyoto Member nations can deal with states individually, there is less allure to meet U.S. demands. This is something that California should keep in mind as it begins to consider opening discussions with foreign governments. In the end, California should proceed gingerly when attempting to bridge markets. The more that California attempts to engage in negotiations about economic or political discrepancies between trading systems, the more likely that it will enter the realm of foreign policy.

While it is uncertain whether it would be possible for California to create an economically advantageous and politically feasible trading system with foreign governments considering the constitutional limits inherent, it would be prudent for the California Air Resources Board to include a severability clause in relation to any regulations linking California with foreign carbon markets. With that added protection, California could ensure that a cap-and-trade system could still exist within the state even if it was unable to formally establish a trading relationship with foreign governments.

III. Conclusion

In this promising time for GHG regulation in California, the state faces some critical choices about how to structure its cap-and-trade program. Its decisions will create different political winners and losers and will have distinct implications for the program’s efficiency, equity, and administrative costs. Among the many factors that California ought to consider are the constitutional implications of combating leakage and extending a trading market into international territory.

This Article has first illustrated that the fate of California’s ability to control leakage will hinge on whether California can take actions without triggering strict scrutiny under the dormant Commerce Clause. Facially discriminatory laws, laws with discriminatory effects or purposes, or laws that regulate outside a state’s jurisdiction always face strict scrutiny. Accordingly, such laws are almost never upheld.

When a law is nondiscriminatory and does not reach outside the state’s jurisdiction, courts are likely to utilize the less stringent *Pike* balancing test. In large part, *Pike* requires courts to weigh the burden a law places on interstate commerce against the purported benefit of the law.

Because of the subjective nature of this test, the upshot of judicial review is often difficult to predict. Part of the challenge is that this balancing test requires the reviewing court to balance incommensurate values. Courts must weigh a state’s interests and purposes against the burdens that the law places on interstate commerce.

To succeed under the *Pike* test, California should find a way to regulate the carbon content of electricity by focusing entirely on California entities. In doing so, it should ensure that its regulation does not place an unequal burden on out-of-staters who are navigating the regulations in order to achieve compliance.

Finding the right balance may prove challenging. But creating a program that exceeds constitutional limits will prove fatal. If California invests ahead of time in addressing constitutional concerns, it will not have to invest after the fact in defending a program that cannot withstand judicial scrutiny.

This Article has also illustrated how international linkages between California’s trading market and the carbon markets of other nations might be effective. The agreement between Governor Schwarzenegger and Prime Minister Blair, and subsequent agreements with state and provincial governments within Australia and Canada, may yield a ground-breaking step toward an efficient market in GHG emissions trading throughout the world. But it is important first to determine whether it is constitutionally permissible for California to enter into such agreements with foreign

92. 441 U.S. 434 (1979).

93. *Id.* at 448.

94. See EU-ETS TRADING SCHEME, *supra* note 47.

nations. Action by California that is directed toward foreign governments may be preempted by the dormant foreign relations power under the *Garamendi* exception. Of course, *Garamendi* is a limited holding, and the facts of *Garamendi* may be distinguished from a GHG trading program in California that would incorporate trading with foreign nations.

As it begins to develop a program to address GHG emissions, the California Air Resources Board should attempt to emphasize the differences between *Garamendi* and any link between California and foreign nations in order to make a future trading program robust. In particular, the board should highlight the private, as opposed to public, nature of a trading market. The board should also develop a record

that demonstrates how GHG trading markets can be classified as a traditional state interest. Finally, the Board should consider including a severability clause in its regulations that would allow it to terminate relations with the EU if necessary while keeping the rest of a trading program intact. Overall, it may be legally difficult for California to develop relations with foreign nations in an attempt to combat global warming and even potentially to enter into the EU-ETS or other foreign carbon trading markets, but California may decide the benefits are worth the effort. If so, as it moves forward, California should remain aware of the legal challenges and attempt to avoid interfering with international negotiations surrounding climate change reductions.