

April 16, 2015

## May Provinces (or States) Limit Imports on the Basis of Greenhouse Gas Emissions Elsewhere?

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**Report Commented On:** Canada's Ecofiscal Commission, [The Way Forward](#)

Last week, a group of economists known as "Canada's Ecofiscal Commission" issued a [much-discussed report](#) that urged Canada's individual provinces to drive Canadian climate policy by adopting their own carbon pricing schemes. But the report barely touched on one of the key challenges for provincial or state regulation without the support of the national government: what may places that price carbon do to avoid losing industry to places that don't?

This is an urgent question across North America because, for different reasons, Canada and the United States are unlikely to adopt uniform nationwide climate policies in the near future. In Canada, the conservative government has repeatedly delayed federal climate regulations and the leader of the liberal party has [pledged to leave the provinces in charge of carbon pricing](#). In the United States, congressional inaction has pushed President Obama to [rely on a rarely-used Clean Air Act provision that requires states to adopt their own regulations for power plant carbon emissions](#). Accordingly, climate regulation will be somewhat different in each state and province. But states and provinces lack a key power that national governments use when they adopt climate regulation: the power to adopt trade regulations that control imports. The nation is an economic union so provinces can't limit trade across their borders.

Climate and trade policies often go hand-in-hand because nations that limit carbon emissions worry they will lose industry to nations that do not. After all, if emissions merely shift to other nations, a phenomenon known as "carbon leakage", a single nation's carbon policies won't do much to help the global climate. One way around this problem is to charge a "carbon tariff" on imports that were produced in nations that do not have similar limits on carbon emissions. This charge is calculated by estimating how much carbon was emitted to produce the imported product and then multiplying that quantity by the importing country's carbon price. These tariffs are sometimes called "border adjustments" because, in theory, they are supposed to level the playing field between domestically regulated producers and unregulated foreign ones.

You can't set up a customs house between Manitoba and Ontario, so provinces can't charge a regular carbon tariff. But states and provinces have found a roundabout way to do more-or-less the same thing. For instance, California and Quebec both have cap-and-trade systems that force power plants to purchase a permit for each ton of carbon that they emit into the atmosphere. Crucially, these cap-and-trade systems also apply to power plants in *other* states that export

electricity to California and Quebec. The effect is the same as the customs house: when a purchaser imports electricity into California or Quebec it must pay a charge for all the carbon that was emitted elsewhere to produce that electricity.

So can states and provinces place a charge on imports that accounts for how much carbon was emitted elsewhere to produce them? It's a crucial question because such charges could apply to all kinds of goods, not just to electricity. Provinces like British Columbia and states like California are already setting standards for motor fuels that effectively charge imported fuels for the greenhouse gases that were emitted elsewhere in their production. And in theory the same charges could apply to any kind of good. You would just add a surcharge to every item based on the greenhouse gases that were emitted elsewhere to produce it: television sets, fruit, toys, you name it.

In fact, state and provincial climate regulations across North America are increasingly adopting exactly these kind of controls, adding urgency to the underlying legal question: [may energy importers export their regulation to cover emissions outside their borders?](#) In the absence of national action on climate change, provinces are looking for creative ways to make sure that they don't lose industry to provinces that don't regulate, so they're regulating imports based on carbon emissions elsewhere.

Canada's Ecofiscal Commission is recommending provincial action on climate but it has little to say on this crucial topic, and what it says is confusing. The report's section on "competitiveness" has a subheading titled "Border adjustments could level the playing field," which sounds promising. It then says "border adjustments could not be implemented by a single province, but would require involvement by the federal government," which is a major qualification. But then it states that, after all, such adjustments are possible for "specific emissions that fall under provincial jurisdiction" and cites the example of Quebec's electricity imports. For this proposition it cites a white paper on a U.S. cap-and-trade system written by U.S. law students.

This issue is too important to gloss over. If states and provinces are going to lead the fight against climate change, many legal decisions and many academic pieces will be written on the topic before it is resolved. This post merely flags some of the key rules and arguments that will be in play.

The normal rule has been that states and provinces may not adopt regulations for pollution emitted in other states. These forbidden rules are known as "extraterritorial" regulations. In [Interprovincial Co-Operatives Ltd. v. Dryden Chemicals Ltd.](#), [1976] 1 SCR 477, the Supreme Court of Canada held that Manitoba could not make a law punishing companies that lawfully emitted pollutants in Saskatchewan and Ontario, even if those pollutants made their way into Manitoba. The rule in the United States is more complicated, but under what is known as the "dormant commerce clause", the U.S. Supreme Court has held that states cannot adopt a law "[if the practical effect of the regulation is to control conduct beyond the boundaries of the State.](#)"

One important reason for the normal rule is that if provinces or states began banning products that were produced elsewhere in ways that they didn't like, they would quickly run afoul of *international* trade laws. For example, if Ontario banned all products made by laborers that were not paid its \$11 per hour minimum wage that would, as a practical matter, end imports from the developing world. It would also conflict with the General Agreements on Tariff and Trade that govern international trade.

On the other hand, the traditional rule against extraterritorial regulation is on somewhat tenuous footing. In Canada, *Interprovincial Co-Operatives* involved a 3-1-3 split, which makes the primary ruling open to debate. The decision is also four decades old and has been heavily criticized, including by one of Canada's leading constitutional scholars. See Peter Hogg, *Constitutional Law of Canada*, 5<sup>th</sup> ed., (2007) at 13-10. Similarly, in the United States, [scholars](#) and [judges](#) have suggested that limits on extraterritorial regulation should be abandoned.

Suffice it to say that import regulations may have a better chance of being upheld where their extra-provincial effects are deemed incidental to their primary purpose, or “pith and substance” in Canadian jurisprudential terms ([Reference re Upper Churchill Water Rights Reversion Act](#), [1984] 1 SCR 297. See also Shi-Ling Hsu and Robin Elliot, “[Regulating Greenhouse Gases in Canada: Constitutional and Policy Dimensions](#)” (2009) 54 McGill LJ 463).

And perhaps the normal rule should bend in the case of provincial climate regulation. For one thing, even if carbon emissions occur in Alberta, they still affect the global climate, which could harm Ontario, Quebec, and every other place in the world. For the same reason, it is vital that climate regulation doesn't just shift carbon emissions to other provinces: few will want to regulate if the provinces that do lose jobs without securing any net benefit for the climate. If we want provinces to set a model for eventual national regulations, maybe they need the same trade powers.

States and provinces also have long-standing authority to manage the mix of sources providing power to their electrical grid, which includes regulating contracts for electricity imports. This helps to ensure that power will always be available at reasonable prices. But there are limits to this authority as well: a province certainly could not prescribe the wages or working conditions for employees at power plants in other provinces. Can provinces prescribe carbon standards for power plants elsewhere under their traditional authority over electricity markets? That remains an open question.

So far, the U.S. courts are divided on whether states may regulate based on carbon emissions elsewhere. [An appellate court said that California could regulate fuels based on emissions elsewhere and a district court said that Minnesota could not regulate electricity based on emissions elsewhere](#). The Canadian courts have not yet addressed the question. And the first two Canadian cap-and-trade systems are poor test cases because both Quebec and Ontario import far less electricity than they export. But the question will become unavoidable as more provinces adopt the kind of policies recommended in the Ecofiscal Commission's report.

Finally, these questions will grow more pressing as long as national governments delay action to address climate change. As with [recent provincial efforts to improve environmental impact assessments of interprovincial pipelines](#), the federal policy vacuum is pushing provinces to act on their own. In the United States, one interim solution could be for [the federal government to allow non-discriminatory state regulation of energy imports](#). If Canada's government is serious about

sticking with provincial climate policy, it may have to consider similarly creative solutions. In the meantime, these policies will continue to present difficult and novel legal questions about the boundaries of state and provincial authority.

*This post originally appeared on James Coleman's blog [Energy Law Prof](#).*

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