U.S. Supreme Court Passes on Dormant Commerce Clause Challenge

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While some were speculating that a recent Kentucky severance tax case may lead to a new Dormant Commerce Clause precedent, the U.S. Supreme Court has officially decided to pass on this issue – meaning the Sixth Circuit's holding as to Dormant Commerce Clause jurisprudence stands.

In *Foresight Coal Sales, LLC v. Kent Chandler et al.*, No. 21-6069 (6th Cir. 2023), the Sixth Circuit Court of Appeals reversed the district court's decision, instead holding that Kentucky's 2021 Senate Bill 257 does discriminate against interstate commerce in its practical effect and purpose, violating the Commerce Clause.

Kentucky imposes a severance tax on the gross value of minerals, such as coal, extracted in the state. Although the severance tax has been a staple in Kentucky's tax code for many years, as the state has developed, the severance tax has caused some unexpected disadvantages for Kentucky coal producers.

One in particular, which is at the forefront in *Foresight*, is the Kentucky Public Service Commission's (PSC) fuel adjustment clause of its determination of "reasonable" utilities prices.

The PSC regulates utilities in Kentucky, including maintaining "reasonable" energy rates for consumers. One way it does this is by allowing utility companies to adjust their base rates by fluctuating fuel costs. In essence, Kentucky utilities are encouraged to purchase the cheapest coal in order to maintain "reasonable" utility rates for its customers. Because of Kentucky's severance tax impact, and that most other coal-producing states do not impose a severance tax, this has historically led utility companies to not purchase Kentucky coal as it is not the cheapest option and could result in a "not reasonable" price finding by the PSC, as the utility company *could* have chosen cheaper fuel.

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Given this push and pull between the coal industry and the longstanding impact of the severance tax, the Kentucky General Assembly has made several efforts to resolve this issue to encourage more in-state purchasing of coal, such as 2021 Senate Bill 257 directing the PSC to subtract severance tax paid from the bid price when determining the reasonableness of coal prices.

Foresight Coal, an Illinois coal producer, challenged the legislation, alleging it was a violation of the Commerce Clause as it favored coal producers in severance tax states over producers in non-severance tax states. The district court denied Foresight Coal's motion for injunctive relief and the case was appealed to the Sixth Circuit.

Characterizing this legislation as the state's attempt to "have its cake and eat it too," the Sixth Circuit Court of Appeals reversed the district court's decision and held that this policy results in coal from states with severance taxes being cheaper and thus burdening interstate commerce.

Although the Sixth Circuit noted the notoriously muddy waters of the Dormant Commerce Clause, the Court nevertheless waded through the variety of case law interpreting the doctrine. Both parties agreed that unconstitutional discrimination is defined by differential treatment that benefits in-state economic interests and burdens out-of-state economic interests, as well as the fact that a law can violate the Commerce Clause on its face as well as through a discriminatory effect. However, the parties took different positions as to the reach of the Dormant Commerce Clause.

Foresight Coal took a broader approach, arguing that discriminatory purpose is enough to violate the Commerce Clause. It argued that if the law's designed effect is to discriminate out-of-state commerce and benefit in-state commerce, which was the conceded purpose of SB 257, it must violate the Commerce Clause.

The PSC alternatively argued that there must be more than discriminatory purpose; rather, there must be significant evidence that the actual impact of the law creates a burden on interstate commerce.

Ultimately, the Sixth Circuit held that it interprets Commerce Clause jurisprudence to require a discriminatory purpose, but regardless,

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SB 257 was discriminatory in effect and in purpose.

The district court found for the PSC noting that the cost of fuel is only one of several factors the PSC must consider when making a reasonable decision. Rather, the district court held that because there was evidence of at least one utilities company purchasing more expensive coal based on other considerations even with SB 257 in effect, Kentucky utilities may still purchase out-of-state coal and thus does not provide evidence that it is discriminatory.

The Sixth Circuit instead held that the district court used the wrong legal analysis. The Sixth Circuit chose a broader interpretation of Commerce Clause precedent finding that "the question the Commerce Clause cases ask is whether SB 257 burdens Illinois coal, not whether that burden is so insurmountable that no Illinois coal will ever again be sold to a Kentucky utility…[t]he question isn't even whether Foresight will necessarily lose market share. Instead, any economic disadvantage will do – whether measured in loss of market share or in lost profits due to decreased prices."

Further, the PSC argued that the parties weren't "burdened" or "benefitted" by SB 257 because the law creates an even playing field from the previous calculations, which inherently disadvantaged states with severance taxes. The Sixth Circuit disagreed. The Court held that despite a "leveling effect" the law must still have a discriminatory impact to achieve such leveling and thus still violating the Commerce Clause. The Court held, "such a tit for tat is precisely the kind of economic balkanization the dormant commerce clause seeks to prevent."

The Sixth Circuit clearly drew a line in the sand. It decided that it would follow a broader interpretation of the Commerce Clause noting a certain level of evidentiary support is not required to prove a law burdens interstate commerce.

Although it was speculated that the U.S. Supreme Court may take the PSC's appeal of this case given its recent history relating to limiting the expansion of Constitutional interpretations, on October 2, 2023, the U.S. Supreme Court denied the PSC's petition for a writ of certiorari.

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The Sixth Circuit ruling stands, and the General Assembly must go back to the drawing board as to solutions for in-state purchasing of coal. It will also be important for practitioners to consider the impact of the Sixth Circuit's decision on other Dormant Commerce Clause litigation.

For more information, contact any attorney with Frost Brown Todd's Tax practice group

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