COMMERCE CLAUSE IMPLICATIONS OF ALLCO FINANCE LTD. CHALLENGES TO CONNECTICUT AND MASSACHUSETTS RPS PROGRAMS

CASE NOTE

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by

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About This Report

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This note summarizes the implications of two pending lawsuits, *Allco Finance Ltd. v. Klee et. al.*[1] and *Allco Renewable Energy Limited v. National Grid*[2] filed by Allco, a renewable energy developer. The lawsuits allege that the Connecticut and Massachusetts renewable energy portfolio standards (RPSs) and renewable procurement programs discriminate against out-of-region renewable energy generation and therefore violate the Commerce Clause of the United States Constitution. The Allco suits are noteworthy because they raise question of first impression regarding the constitutionality of in-region rather than in-state RPS eligibility requirements, and are significant since they put to legal test commenters predictions[3] that regional restrictions would likely carry less risk of challenge than state-locational requirements.

This note build on previous notes for the RPS Collaborative on RPS-related lawsuits.[4]

I. BACKGROUND ON ALLCO

Allco, the plaintiff in both the Connecticut and Massachusetts litigation, is a company that develops and operates various solar projects located in Connecticut, Georgia, and New York. Allco's projects are self-certified as Qualifying Facilities (QFs) under the Public Utilities Regulatory Policies Act (PURPA).[5] Over the years, Allco has raised numerous challenges before the Federal Energy Regulatory Commission (FERC) and state and federal courts pertaining to renewable energy programs in various jurisdictions.[6] Allco's Commerce Clause challenges to the

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[1] Case No. 3:15-cv-00608-CSH (D. Conn., filed April 26, 2015)("Connecticut Case").

[2] Case No. 1:15-cv-13516-PBS (D. Mass, Amended Complaint, filed February 11, 2016).

[3] *W. Griffin, Renewable Energy Portfolio Standards and the Dormant Commerce Clause: The Case for In-Region Location Requirements, 41 B.C. Envtl. Aff. L. Rev. 133 (2014), http://lawdigitalcommons.bc.edu/ealr/vol41/iss1/4.*

[4] See Carolyn Elefant, *RPS Collaborative Note on North Dakota v. Minnesota PUC* (April 2014), *Commerce Clause Analysis of People v. Nazarian and Soloman v. Hanna* (March 2014), and *Implications for State RPS Programs of Illinois Commerce Commission et al. v FERC* (June 2013). For a more general study of the relationship between the interstate commerce clause of the U.S. Constitution and the design of state RPSs, see Carolyn Elefant and Ed Holt, *The Commerce Clause and Implications for State Renewable Portfolio Standard Programs* (March 2011).

[5] Connecticut Complaint, ¶13.

[6] For example, Allco has pursued various claims against the Massachusetts Department of Public Utilities and National Grid, asserting that its solar QFs are entitled under the Public Utilities Regulatory Policies Act (PURPA) to long-term contracts with National Grid at a price equal to the avoided costs used to justify National Grid's purchase rates for the Cape Wind Offshore Wind project. *See Allco v. Massachusetts Electric Company*, 146 FERC ¶61,107 (2014)(summarizing PURPA litigation between parties but finding complaint premature until final determination by DPU regarding avoided cost rates). Allco has also been involved in PURPA litigation in California related to avoided cost pricing for QFs. *See Winding Creek Solar et. al. v. CA PUCO*, 15 F.Supp. 3d 395 (N.D. Cal. 2014)(dismissing claims on standing grounds).

Connecticut and Massachusetts RPS programs are not raised as stand-alone claims, but are part of Allco's broader attacks on other renewable energy programs within each state.

II. THE CONNECTICUT COMMERCE CLAUSE CLAIMS

In Connecticut, Allco's current Commerce Clause litigation grew out of an earlier, unsuccessful challenge to Connecticut's long-term renewable energy procurement programs. With projects located in New York and Georgia, Allco did not qualify for the Connecticut Department of Energy and Environmental Protection (DEEP) 2013 solicitation because neither project would deliver power into the New England region and qualify for renewable energy certificates (RECs), which was one of the requirements of the procurement. Allco sued, arguing that DEEP's program did not comply with PURPA's procurement requirements and violated the Supremacy Clause since the resulting contracts with the state's local distribution companies encroached on the FERC's exclusive authority over wholesale rates. The federal district court dismissed Allco's claims, and its ruling was affirmed by the Second Circuit.[7]

In April 2015, with its earlier lawsuit pending appeal, Allco filed a second suit challenging the Connecticut DEEP's 2015 renewable energy procurement, again on Supremacy grounds. But this time around, Allco raised a Commerce Clause challenge to the Connecticut RPS program.

As Allco's Complaint describes, Connecticut's RPS, Conn. Gen. Stat. §16-245a(b)(1) allows utilities to comply with the RPS by purchasing certificates issued by the New England Power Pool (NEPOOL) Generation Information System provided that those RECs fall into one of two categories. The first type of qualifying RECs are for energy produced by a renewable generator *located* within the New England independent system operator (ISO) control area, which includes Connecticut, Massachusetts, Vermont, New Hampshire, Rhode Island, and Maine. The second type of qualifying RECs are for energy imported into the control area of the regional ISO pursuant to New England Power Pool Generation (NEPOOL) Information System Rule 2.7(c). Rule 2.7(c) in turn requires that energy for RECs be imported from a "generating unit located in an adjacent control area" to ISO-New England, which means either ISO-New York, the area in Northern Maine administered by the Northern Maine Independent System

[7] *Allco Finance Limited v. Klee*, Civil No. 3:13-cv-1974 (D. Conn. December 10, 2014). The lower court dismissed Allco's claims, finding that Connecticut's procurement program did not violate the Supremacy Clause because the program did not set rates for wholesale sales by the generator to the local utility. In November 2015, the Second Circuit affirmed the lower court's dismissal, albeit on different grounds, finding that Allco failed to exhaust PURPA's administrative remedies by first bringing its challenge to FERC. *Allco Finance Limited v. Klee*, 805 F.3d 89 (Second Cir. November 2015).

Administrator, or Quebec and New Brunswick in Canada.

Allco argues that Connecticut's RPS discriminates based on location and therefore violates the Commerce Clause. Allco alleges that the statute is facially discriminatory[8] since RPS benefits are tied to physical location that cannot be met by generators outside of the region or adjacent region. Here, Allco takes the position that regional discrimination—*i.e.*, state discrimination against 40 other states is as much a violation of the Commerce Clause's prohibition on in-state preference as discrimination against all out-of-state interests. Allco then continues by addition that even projects physically located in an adjacent region—such as its New York QFs—are unduly burdened by the Connecticut RPS eligibility requirements in violation of the Commerce Clause because those projects cannot qualify unless they can obtain "potentially costly transmission rights to transmit the energy to ISO-New England."[9] Allco also argues that even though NEPOOL—a federally approved body that the state relies on for REC compliance—established the locational requirements, Connecticut did not have to adopt these restrictions and could have developed another compliance system. Allco's Complaint seeks a declaration that "would allow RECs from *any* energy generator in the United States to qualify as RECs in Connecticut."

Interestingly, Allco *did not* challenge "Connecticut's power to require that RECs be related solely to facilities located within its borders—such as specialty RECs that are part of Connecticut's low-emission renewable energy credits (LREC) and zero-emission renewable energy credit (ZREC) programs."[10] In fact, it bears mention that Allco owns solar facilities that participate in these Connecticut programs. However, Allco states that the reason that it does not challenge Connecticut's LREC and ZREC program is because the Federal Power Act (FPA) reserves to states the authority to regulate the character of electric generating stations within its own borders—perhaps suggesting that any resulting discrimination is effectively approved by Congress and therefore, inoculated against a Commerce Clause challenge.[11] This theory, however, was rejected by a federal district court in *PPL EnergyPlus v. Nazarian*, which concluded, that the FPA does not demonstrate a "clear and unambiguous intent on behalf of Congress to permit states to discriminate against interstate commerce" when limiting benefits to an in-state generation facility.[12] Moreover, it goes without saying that a court is likely to view

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[8] A "facially discriminatory" statute is one that expressly favors in-state interests or discriminates against out-of-state interests based solely on location.

[9] Allco Complaint at ¶26.

[10] Complaint at n. 5.

[11] The Commerce Clause provides that "no state shall make a law" interfering with interstate commerce, but does not impose a similar prohibition on the federal government.

[12] *PPL Energy*, 974 F. Supp. 2d 790 (D. Md. 2013) (finding that in-state location requirement as condition to compete for subsidized contracts implicates the Commerce Clause, but is justified as sole means to address state's reliability goals).

as disingenuous Allco's defense of Connecticut's purported "protectionism" (in Allco's words) when it protects Allco's own in-state projects but criticizes those same restrictions when they operate to exclude Allco's out-of-region projects.

Connecticut moved to dismiss Allco's complaint on several grounds. Connecticut opens by arguing that the RPS is a subsidy that the state can spend as it wishes; and second, the RPS is subject to the market participant rule, under which a state participating in the market as a competitor rather than a regulator can establish rules to favor in-state interests. Both of these arguments were rejected in *PPL Energy v. Nazarian*, *supra*.[13] There, a Maryland federal district court found that the state's "contract for differences" program (designed to provide an in-state supplier with additional payments to incentivize location of a natural gas-fired plant in Maryland) was neither a subsidy, since the Public Service Commission "is not directly funding or providing pecuniary aid" through taxes or bonds, nor protected by the market participant doctrine since the state was not buying or selling directly in the energy market.

Next, Connecticut contends that its RPS program does not discriminate against out-of-state interests and therefore does not violate the Commerce Clause. First, Connecticut proffers statistics to back up its claim, which show that "fully ninety percent of Connecticut Class I RECs originate from outside the state."[14] Second, Connecticut seems to take the position that regional, locational restrictions do not offend the Commerce Clause because they do not favor an in-state commercial interest. This is an interesting argument, and one that has not before been addressed since regional, locational restrictions have not previously been subject to challenge.

Finally, while Connecticut acknowledges that its statute bases REC eligibility on NEPOOL's requirements, Connecticut argues that the fact that NEPOOL's regulations limit REC eligibility to projects in the ISO-New England control and adjacent areas does not violate the Commerce Clause. Connecticut explains that the NEPOOL eligibility requirement was "created under the auspices of a federally approved NEPOOL governance structure…" and that because NEPOOL is federally approved, its standard–even with its restrictions on out-of-region RECs—does not violate the Commerce Clause because only states, not Congress are barred from discrimination. Connecticut argues that NEPOOL's restrictions, which are constitutionally acceptable when directly implemented by NEPOOL, cannot be regarded as "somehow discriminat[ing] against interstate commerce when incorporated by a state."[15] Connecticut also suggests that its adoption of the NEPOOL standard is the most efficient way to ensure the

[13] See Elefant, *Commerce Clause Analysis of People v. Nazarian and Soloman v. Hann*.
[14] Connecticut DEEP Memorandum in Support of Motion to Dismiss (June 19, 2015), Docket No. 3:15-CV-0608.
[15] Connecticut Memo at 32-33.

integrity of its RPS program, and therefore, a rational and non-discriminatory reason justifies what might otherwise be characterized as a discriminatory practice.

According to the court docket sheet, a nearly two-hour argument on Allco's complaint—which includes both the Commerce Clause and Supremacy Clause arguments—and the motion to dismiss was heard before a federal district court judge on May 3, 2016. Unless the parties settle (and as best we could determine, none of Allco's other cases settled), a ruling can be expected sometime in the next few months.

III. THE MASSACHUSETTS COMMERCE CLAUSE CLAIMS

As in Connecticut, Allco's Massachusetts Commerce Clause complaint was also preceded by litigation against the Massachusetts Department of Public Utilities (DPU) alleging that it violated PURPA by setting avoided cost rates equal to the hourly spot market prices in the ISO-New England market instead of at the higher long-term contract costs based on rates that National Grid had agreed to pay under a long-term contract with Cape Wind. Allco brought its PURPA case in Massachusetts state court, then to FERC. Finding no relief, in February 2016, Allco sued the DPU in federal court, reiterating its PURPA claims and also challenging the Massachusetts RPS program on Commerce Clause grounds.

Massachusetts's RPS, set forth in 225 CMR §14.05 *et. seq.,* operates the same as the Connecticut program: to qualify for RECs, generation must either be located within the ISO-New England footprint, or in an adjacent control area and delivered into the ISO-New England region. The Massachusetts RPS also has a solar carve-out for small, in-state solar projects which was the subject of a suit by TransCanada several years ago,[16] but is not challenged in Allco's suit.

As in Connecticut, Allco argues that the Massachusetts RPS program facially discriminates against out-of-region facilities by making RPS eligibility dependent upon a generator's physical location within the ISO-New England or adjacent control region. Allco also argues that the RPS requirement unduly burdens projects in the adjacent control region since they must acquire costly transmission rights to deliver into the ISO-New England and therefore, cannot compete with projects already located in the ISO region.

Although Allco's Massachusetts suit was filed more than five months ago, the Commerce Clause issues have not been briefed by the parties. The Massachusetts DPU filed an answer denying Allco's various allegations, but it has not yet filed a brief defending its program as Connecticut did in the other lawsuit. At this point, the parties in the Massachusetts case

[16] For a summary of this case, see Elefant and Holt, *Commerce Clause and Implications*, pp. 19-23.

seem to have focused entirely on the PURPA component of the suit, which is set for a hearing in July 2016. Given the current status of the Massachusetts suit, it is likely that a decision on the Connecticut RPS will issue first—and will potentially inform a future ruling in Massachusetts.

IV. IMPLICATIONS OF ALLCO'S LAWSUIT

A decision in the Allco suit will offer guidance on whether regional eligibility requirements—or at least regional requirements resembling those crafted by Connecticut—will pass constitutional muster. Although it is always difficult to predict the outcome in a matter of first impression, it is this author's view that the specific details of the Connecticut RPS program militate in favor of it surviving review. In particular, that just ten percent of Connecticut's RPS is satisfied by in-state jurisdiction coupled with Connecticut's adoption of an RPS eligibility requirement developed by NEPOOL, a federally approved organization without any motive to favor in-region generation (even though a federal entity, it has authority to do so) are facts that may persuade the court to find that the Connecticut RPS does not have a discriminatory motive. In addition, even if a court were to review NEPOOL's locational requirements as discriminatory, Connecticut's argument that the existing NEPOOL tracking system offers the only mechanism to enable Connecticut to insure compliance with its RPS program provides a rational, non-discriminatory basis for adopting NEPOOL's system.

In contrast to Connecticut's strong defense of its RPS, Allco's arguments were not as coherent. For example, Allco faults Connecticut's RPS program for being protectionist by excluding Allco's Georgia projects from RPS eligibility, yet on the other, Allco defends Connecticut's in-state location requirements, which are far more protectionist, presumably because they benefit Allco's Connecticut projects. In addition, although Allco argues that its New York projects will be disadvantaged by the "potentially costly" transmission rights that they must acquire to deliver power to the ISO-New England, Allco does not offer any evidence on the magnitude of these costs or whether they would place Allco's projects at an economic disadvantage.

Another issue that the Connecticut litigation may resolve is whether a state like Connecticut that chooses to incorporate a location-based RPS eligibility standard established by a federally-approved system operator such as NEPOOL would be insulated from a Commerce Clause challenge entirely. After all, given that a federal system that discriminates against out-of-region resources does not violate the Commerce Clause (because only states, not the federal government are prohibited from interfering with interstate commerce), it seems unfair to prohibit the state from relying on the federal standard.

As mentioned earlier, the Massachusetts case has not yet been briefed. However, given the similarities between the Connecticut and Massachusetts programs, it seems likely that a ruling in the Connecticut case will inform the outcome of the Massachusetts proceeding.

V. CONCLUSION

Many states rely on already existing, federally approved tracking mechanisms to facilitate compliance with their RPS, while some restrict eligibility of out-of-region rather than out-of-state RECs, believing that regional restrictions may mitigate any possible discriminatory effects. A ruling declaring the Connecticut RPS unconstitutional would be problematic because it would overturn other similarly structured state programs. And while states could address some of these adverse impacts by revising their RPS statutes to make eligibility dependent on regional deliverability rather than regional locational requirements,[17] states cannot force federal operators like NEPOOL to change their REC eligibility requirements. Thus, states like Connecticut that rely on NEPOOL to implement and enforce their RPS programs might be forced to develop their own enforcement mechanisms if the court finds the Connecticut statute's adoption of NEPOOL's regional locational requirements unconstitutional.

[17] For example, a state that grants RPS eligibility to projects *located* in the ISO-New England footprint could be revised to grant RPS eligibility to projects located anywhere in the United States but that are capable of delivering power to the ISO-New England market.




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