THE COMMERCE CLAUSE AND IMPLICATIONS FOR STATE RENEWABLE PORTFOLIO STANDARD PROGRAMS

CLEAN ENERGY STATES ALLIANCE STATE RPS POLICY REPORT

by

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and

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The Commerce Clause and Implications for State Renewable Portfolio Standard Programs

Executive Summary

Twenty-nine states and the District of Columbia have adopted mandatory renewable portfolio standards (RPS) that require the state's retail utilities to procure a certain percentage of their energy requirements from renewable energy resources. To capture the in-state benefits of RPS-stimulated renewable development, many state programs impose in-state location or delivery requirements as a condition of RPS eligibility. Other states limit the amount of out-of-state power that a utility may use to satisfy the RPS. More recently, some states have required utilities to "carve out"[1] a portion of their RPS obligation for distributed generation (primarily solar).

While most RPS programs are motivated by state goals such as improved environmental health or diversity of supply, states also hope to reap economic benefits from a renewable industry in-state. The Commerce Clause of the United States Constitution, however, prohibits states from favoring local industry to the disadvantage of out-of-state competitors for economically protectionist reasons. As such, the constitutionality of state RPS programs has been the subject of analysis under the Commerce Clause.[2] However, no state RPS program was ever formally challenged in court until last year.

In April 2010, TransCanada, a North American energy company, filed a suit in federal district court challenging the state of Massachusetts' RPS under the Commerce Clause in two respects: (1) the set-aside for solar distributed generation located in-state and (2) the in-state eligibility requirement for long-term renewable power sales contracts that utilities must procure under state law.[3] Although the parties have put the case on hold

[1] This design option is also known as a set-aside, a different target for different renewable energy technologies or applications.

[2] *See, e.g.*, N. Rader, S. Hempling, *The Renewables Portfolio Standard: A Practical Guide,* Prepared for National Association of Regulatory Utility Commissions (2001) ("NARUC Report") (evaluating Commerce Clause implications of RPS programs); *also K. Engel, The Dormant Commerce Clause Threat to Market Based Environmental Regulation: The Case of Energy Deregulation*, 26 Eco. L.Q. 243, 271-272 (1999); P. Jacoby, 30 Vt. L. Rev. at 1132, 1134 (2004); S. Ferrey, *Sustainable Energy, Environmental Policy and States Rights: Discerning the Future of Energy Through The Eyes of the Commerce Clause*,12 N.Y.U. Envir. L.J. 507, 604 (2009).

[3] *TransCanada Power Marketing LTD v.* Bowles, CA No. 4:10cv-40070-FDS (April 16, 2010).

in light of a partial settlement, the TransCanada suit has revived lingering concerns over the constitutionality of certain provisions in state RPS programs.

In light of this uncertainty, the objective of this report is to identify and discuss options available to states for structuring RPS programs in a constitutionally compliant manner. Part I provides an overview of the requirements of the Commerce Clause and how they might affect certain types of RPS programs. Part II describes options available to states to retain the state-specific benefits of RPS programs without running afoul of the Commerce Clause. These include:

- Craft facially neutral[4] RPS eligibility requirements, such as in-state delivery or consumption requirements that apply equally to all resources irrespective of location;

- Evaluate the feasibility of re-casting location-based eligibility requirements in a facially neutral manner;

- Emphasize the state's interest in legitimate, non-protectionist goals such as environmental protection, reliability, energy conservation and diversity of power supply when drafting or reauthorizing RPS legislation or regulations;

- If location-based requirements are employed, opt for in-region location eligibility requirements which are more likely to withstand constitutional challenge than in-state location requirements;

- Where location-based eligibility RPS requirements are employed, build a legislative or administrative factual record showing that the state has no other alternative to achieve legitimate goals;

- Phase in new in-state RPS requirements gradually, or limit rather than prohibit out-of-state eligibility, to minimize impacts on affected parties. While these measures will not cure constitutional infirmities, they may significantly reduce litigation risk.

Because this review was prompted by a Commerce Clause challenge, an Appendix includes a case study of TransCanada's legal challenge to the Massachusetts procurement statute and distributed generation set-aside.

[4] In the commerce clause context, the term "facially neutral" means that the statute or regulation applies impartially to both in-state and out-of-state business and does not explicitly classify on the basis of in-state or out-of-state location.

I. Dormant Commerce Clause Issues and Implications for RPS Programs[5]

A. Commerce Clause Overview

The Commerce Clause of the U.S. Constitution empowers Congress "[t]o regulate Commerce… among the several states."[6] While expressly granting Congress authority to regulate interstate commerce, the Commerce Clause also has a negative or "dormant" clause that restricts states from "unjustifiably…discriminat[ing] against or burden[ing] the interstate flow of commerce."[7] This negative aspect of the Commerce Clause prohibits economic protectionism—that is, "regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors."[8]

1. Facially discriminatory laws

a. Facially discriminatory laws are virtually per se invalid

Statutes that discriminate on their face violate the Commerce Clause unless there is demonstrable justification for the discrimination unrelated to protectionism. "Barriers to the free flow of commerce based on point of origin or other geographic factors to benefit local interests are virtually *per se* invalid,"[9] unless the state can identify a non-protectionist and compelling local interest that cannot be served by any other means. The exception for lack of alternatives is extremely narrow; only one facially discriminatory law has avoided invalidation on these grounds.[10]

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[5] The terms "dormant commerce clause" and "commerce clause" are used interchangeably throughout this paper.

[6] U.S. CONST. art. I, §8, cl. 3.

[7] Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 522 (1935).

[8] New Energy Co. of Indiana v. Limbaugh, 486 U.S. 269, 273-74 (1988).

[9] Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978) (holding that New Jersey's ban on imports of out-of-state garbage is a per se Commerce Clause violation).

[10] Maine v. Taylor, 477 U.S. 131 (1986)(upholding Maine law banning imports on out-of-state baitfish finding that no alternatives existed to protect domestic populations from disease).

Facially discriminatory laws take many forms. State laws that block imports[11] or exports[12] of goods across state lines, or impose added taxes or charges on out-of-state goods[13] are considered impermissible barriers under the Commerce Clause. Regional barriers fare no better, since laws that discriminate against some states rather than all states (*e.g.,* a law that forbids a state from importing goods outside of a six-state region still discriminates against 44 other states) also violate the Commerce Clause.[14]

b. Examples of facially discriminatory laws involving the energy industry

A number of Commerce Clause cases involving energy production have overturned state laws creating preferences based on the geographic point of origin of the fuel or energy. Examples of energy-related laws overturned under the Commerce Clause as *per se* invalid include a New Hampshire law prohibiting hydroelectric plants from selling power out of state before offering it for sale in-state;[15] an Oklahoma law requiring in-state plants to burn a mixture of coal containing at least ten percent Oklahoma-mined coal;[16] an Illinois law encouraging use of in-state coal for purposes of compliance with the Clean Air Act[17]and an Ohio law extending a tax credit to users of ethanol from Ohio or from other states granting reciprocal tax advantages.[18]

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[11] Philadelphia v. New Jersey (invalidating ban on imports of trash from other states).

[12] *C & A Carbone v. Town of Clarkstown*, N.Y., 511 U.S. 383 (1994) (striking down town ordinance requiring non-recylable solid waste to be processed at designated facility within municipality before shipping); *South-Central Timber Development Inc. v. Wunnicke*, 467 U.S. 82 (1984) (striking down Alaska regulation that required all Alaska timber to be processed within the state before export).

[13] *Chemical Plant Management Inc. v. Hunt*, 504 U.S. 334, 342 (1992) (invalidating Alabama law imposing extra fee on imported hazardous waste).

[14] *Hunt v. Washington State Apple*, 432 U.S. 333 (1977) (striking down law that banned sale of apples in North Carolina from any states with a grading system other than USDA even though law precluded sales from some but not all states).

[15] *New Hampshire v. New England Power*, 455 U.S. 331 (1982)(holding that law restricting exports of hydropower hoards resources for state's economic advantage).

[16] *Oklahoma v. Wyoming*, 502 U.S. 437 (1992)(finding no de mimimis exception to Commerce Clause that would sustain discriminatory statute requiring utilities to burn mixture of coal that includes minimum of 10 percent of in-state coal).

[17] *Alliance for Clean Coal v. Miller*, 50 F.3d 591 (7th Cir. 1995)(finding that statutory provisions such as granting full rate recovery for scrubbers for plants using Illinois coal statute or requiring utilities to consider local coal industry in developing Clean Air Act compliance plans make use of Illinois coal a more attractive option and thus, violate Commerce Clause).

[18] *New Energy Co. of Indiana*, 486 U.S. 269 (finding that providing tax credits for use of Ohio-produced ethanol as well as ethanol produced in other states granting credits for Ohio ethanol still discriminates against all other states that do not offer reciprocal treatment in violation of Commerce Clause).

One recent Virginia case, *Appalachian Voices v. State Corporation Commission*, is an exception.[19] There, the Virginia Supreme Court upheld a statute that allowed utilities to seek rate approval for facilities that use technology capable of burning Virginia coal. Because the Virginia law did not compel use of Virginia coal, the court concluded that the statute did not significantly burden interstate commerce. *Appalachian Voices* represents a minority view in Commerce Clause jurisprudence because it involved a facially discriminatory law where the court assessed the extent of impact on commerce rather than striking the law as *per se* invalid. The precedential value of *Appalachian Voices* (if any, since it contradicts Supreme Court cases) would be limited to Virginia.

c. Summary regarding facially discriminatory laws

As discussed, the majority of energy-related laws that extend preference based on location have been overturned under the Commerce Clause. *Appalachian Voices* is an exception and runs counter to Supreme Court precedent. As one commentator has observed, "at the very least, [use] of location based language increases the odds that a savvy litigant will challenge the statute."[20] For this reason, RPS statutes that express a preference for projects based on geographic location, either within a state or even within a region, are vulnerable to Commerce Clause challenges.

A state's best opportunity to avoid invalidation of a facially discriminatory law is to demonstrate a compelling interest unattainable in any other manner.[21] The compelling interest test poses a high bar, however. Even a state's interest in environmental health, diverse supply, safety and energy conservation may not save facially-discriminatory state RPS or renewable incentives laws, particularly if more protectionist motives (such as economic development) are evident or another alternative is available. Rather than try to justify a facially discriminatory statute, a preferable approach for states is to craft statutes using facially neutral language.

2. Facially neutral laws with a discriminatory or adverse impact on commerce

When a statute regulates "evenhandedly" and imposes only "incidental" burdens on interstate commerce, courts often apply what is known as the *Pike* analysis, evaluating whether "the burden imposed on such commerce is clearly excessive in

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[19] 675 S.E.2d 458 (2009).

[20] Patrick R. Jacobi, *Renewable Portfolio St*andard Generator Applicability Requirements: How States Can Stop Worrying and Learn to Love the Dormant Commerce Clause, 30 Vt. L. Rev. 1079, 1132 (Summer 2006).

[21] Maine v. Taylor, supra 477 U.S. 131.

relation to the putative local benefits."[22] Local benefits such as energy conservation, waste disposal, improving environmental health or safety will justify a burden on commerce under the *Pike* balancing test; [23] parochial benefits such as subsidizing an in-state industry will not.[24]

In some cases, however, even facially neutral language is so clearly a ruse for protectionist behavior that courts have invalidated the statute without even reaching the *Pike* balancing analysis. For example, *C.A. Carbone*[25]involved a municipal ordinance requiring all solid waste to be processed at a designated transfer station before leaving the municipality. The Court found that in spite of the statute's neutral façade, its real intent was to drive waste to a designated facility to ensure its profitability. In light of the ordinance's protectionist motive, i.e., to protect the profitability of a specific facility, the Court's majority invalidated it without reaching the *Pike* balancing analysis.

Bacchus Imports Ltd. v. Diaz[26] involved another facially neutral statute concealing protectionist motive. There, a Hawaii statute provided a tax exemption for sales of two types of wine, both produced from products uniquely indigenous to Hawaii. All other fruit wines, whether produced in-state or out-of-state, remained subject to the tax. Because no non-Hawaii based companies produced the indigenous wines that received the exemption, the statute created a situation where no out-of-state interests would receive any of the law's benefits. As in *Carbone*, the *Bacchus* Court bypassed the *Pike* balancing test, and invalidated the law as a protectionist-inspired action.

To summarize, where a statute is facially neutral, it is subject to the more deferential *Pike* balancing test. Under the *Pike* test, so long as states can demonstrate that a facially neutral RPS statute advances benefits such as clean energy, environmental health or conservation, the statute will likely survive commerce clause

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[22] Pike v. Bruce Church, Inc., 397 U.S. 137 (1970)(invalidating Arizona law that requires all Arizona produce to be packed and marked in Arizona before leaving the state finding that law does not further state interest in avoiding deceptive packaging or protecting reputation of Arizona fruit).

[23] *See Minnesota v. Clover Leaf Creamery*, 449 U.S. 456, 472-73 (1981); *C & A Carbone*, 511 U.S. 383 (1994) (applying *Pike* to uphold Minnesota statute banning use of environmentally unfriendly plastic milk containers by both in-state and out-of-state sellers notwithstanding burden on out-of-state suppliers in light of state's interest in environmental protection).

[24] *Dean Milk Co. v. Madison County*, 340 U.S. 349 (1951)(invalidating statute prohibiting sale of milk unless pasteurized within five miles of the City because law's purpose is not protection of public health but protecting "major local industry.")

[25] *C & A Carbone*, 511 U.S. 383 (1994).

[26] 468 U.S. 263 (1984).

review.[27] Still, states must take care not to draft facially neutral statutes such as those in *Bacchus* or *Carbone* that limit commerce so substantially that courts will presume a protectionist motive.[28]

3. Market Participant Exceptions

Courts recognize the "market participant" doctrine as an exception to the Commerce Clause's ban on discrimination. The market participant exception applies when a state goes beyond merely regulating a market and instead itself participates in the market.[29] When a state (or local government) enters the market as a participant, it is not subject to the restraints of the Commerce Clause, and may favor its own citizens over others.[30] In most cases, a state is considered a market participant where it owns or fully funded the enterprise that is the recipient of preferential treatment.[31] In these cases, the Court reasons that the state's preference for an in-state public entity over a private one is not discriminatory because all private entities, "whether in-state or out of state are treated exactly the same."[32] In addition, the Supreme Court holds that the Commerce Clause permits states to spend their own funds to participate in the market and can use that money to favor its own citizens.[33]

In most RPS programs, the state would not be considered a market participant since it does not fund or purchase Renewable Energy Credits (RECs) or otherwise participate actively in the REC market. Instead, RECs are merely a regulatory device by

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[27] Several commentators reach this same conclusion, with varying levels of confidence. *See* n.2, *supra*.

[28] *See, e.g. Bacchus, supra* (invalidating facially statute that blocks any out of state companies from receiving benefits).

[29] *Alexandria Scrap v. Hughes*, 426 U.S. 794, 810 (1976)(holding that state is a market participant where it pays a companies that remove truck hulks from junkyards for processing at in-state facilities and thus, does not violate the Commerce Clause by paying bounty to in-state but not out-of-state processors).

[30] *Id; see also White v. Massachusetts Council of Constr. Employers*, 460 U.S. 204, 208 (1983)("When a state or local government enters the market as a participant it is not subject to the restraints of the Commerce Clause.")

[31] *See United Haulers Assoc. Inc. v. Oneida-Herkimer Solid Waste Management Authority*, 550 U.S. 330 (2007)(finding that flow control ordinance requiring haulers to take waste to municipal owned facility prior to export does not violate commerce clause because it "treats private entities in-state and out-of-state the same); *Department of Revenue of Ky. v. Davis*, 128 S. Ct. 1801 (2008)(upholding Kentucky law that exempts interest from state municipal bonds from tax but not interest from out-of-state municipal bonds or private bonds).

[32] *United Haulers* at 334, *supra*.

[33] *Alexandria Scrap v. Hughes*, 426 U.S. at 809.

which to comply with RPS requirements. Thus, the market-participant exception will not apply to the majority of RPS programs, as currently devised.[34]

However, there is a unique RPS program design employed by two states, New York and Illinois, which may satisfy the market-participant exception. In those states, a state agency has direct responsibility to conduct procurement under the RPS. In New York, for example, the New York Energy Research and Development Authority (NYSERDA) is the procurement agent and is authorized to purchase the environmental attributes created by the renewable generation, not the electricity, under long-term contracts. The renewable generator provides NYSERDA with all rights to the RPS attributes associated with each MWh of renewable electricity generated and delivered into the New York Control Area that are under an RPS contract.

Because NYSERDA purchases RECs, it would likely be regarded as a market participant. Thus, if NYSERDA (or any other state with a similar program) chose to purchase RECs only from facilities located in the state, most likely, this program would not violate the Commerce Clause. Though reliance on the market participant exception doctrine is a possibility, it is difficult to predict how courts will rule since application of the market participant exception in the context of energy cases presents a matter of first impression. States are on far stronger grounds if they can create a non-facially discriminatory program, which is a more accepted and traditional basis for avoiding a Commerce Clause challenge.

B. The Commerce Clause Implications of Various RPS Design Elements

This section analyzes the potential applicability of the Commerce Clause to a variety of common RPS design elements including (1) enhanced RPS compliance credit for certain types of generation; (2) delivery-based and location-based eligibility requirements; (3) set-asides for distributed generation and (4) unbundled REC compliance. The design elements discussed are intended as examples only; the analysis should not be viewed as offering a legal opinion on the compliance of any specific RPS statutes with the Commerce Clause.

1. Resource-based eligibility or carve-outs

[34] Two commentators concur with this conclusion. *See* Ferrey, 12 N.Y.U. Envir. L.J. 507, 607 (explaining that RPS standards are implemented by regulation and do not qualify for exception since state does not own the resource or create the market through subsidies); Engel, 26 Ecology L.Q. at 341-342 (acknowledging that market participant exception only applies to state owned or state funded programs).

RPS programs that exclude certain types of renewables from eligibility are constitutionally sound (e.g., Ohio RPS does not include ocean-based renewable energy as an eligible resource). The type of resource eligibility restriction falls equally on both in-state and out-of-state resources and as such, does not discriminate on geographic grounds.

Some state RPS programs include distributed generation (DG) or customer-sited "set-asides," *i.e.,* a requirement that a percentage of a utility's RPS requirement be supplied by DG or customer-sited solar (hereinafter, referred to as DG or solar set-aside). However, RPS set-asides or multipliers (i.e., enhanced compliance credits) for certain types of renewables do not raise Commerce Clause concerns so long as eligibility is not limited to in-state projects. Programs that favor one renewable source over another are facially neutral, while the state's interest in increasing diversity of supply by offering added incentives to spur development of certain types of renewables is compelling. In contrast, set-asides that are limited to in-state resources are discriminatory (e.g., requiring utilities to satisfy RPS with a specified percentage of in-state generation only), and can only be justified by a showing that the state lacks non-discriminatory alternatives to achieve legitimate goals – which is a difficult standard to meet.[35] (See fuller discussion *infra* section 2.)

2. In-state or in-region location v. in-state or regional delivery requirements

States sometimes condition project eligibility on in-state location or delivery requirements. Generally speaking, location-based requirements raise Commerce Clause concerns; delivery-based or other neutral, functional requirements do not, as discussed.

Requirements that a project be located in a state or region to qualify for the RPS discriminate on their face because they treat in-state and out-of-state projects differently solely for geographic reasons. As such, location-based RPS requirements can avoid invalidation under the Commerce Clause *only* if the state can show that there are no other non-discriminatory alternatives available to achieve legitimate state goals. In some cases, a neutral, in-state deliverability or other functional eligibility requirement may provide a viable alternative to an in-state location requirement. For example, a state may argue that there is a legitimate reason for an in-state deliverability requirement because it ensures that "dirtier" generation within the region is displaced. That is, to the extent that fossil-fired generators are displaced, the delivery requirement will improve air quality both locally and in the broader region and contribute to regional development. The absence of such a delivery requirement, on the other hand, provides no certainty of local or even regional economic and environmental benefits. However, it is important to note that where neutral alternatives are available to meet the state's legitimate objective, a location-based RPS violates the Commerce Clause.

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[35] See Part A.1.c, supra.

RPS statutes with functional eligibility requirements, such as in-state deliverability, interconnection or consumption, are facially neutral because any company, whether in or out of a state, can meet these requirements. While an out-of-state developer may face added costs to connect to an in-state distribution facility, the costs are a product of a project's distance to distribution facilities rather than geographic boundaries. Moreover, the added costs are not discriminatory; an in-state project located in a remote or transmission-constrained portion of a large state might also face increased costs in meeting an in-state deliverability or distribution requirement. Overall, commentators generally agree that in-state and regional delivery requirements will survive commerce clause review, while geographic or location-based requirements are vulnerable.

3. DG and Customer Sited Set-Asides

As mentioned, many state RPS programs include DG or customer-sited set-asides, although the eligibility designs vary significantly, ranging from in-state interconnection, a showing of displacement of power (to account for behind-the-meter generation) or in-state location.

Location-based eligibility requirements for DG or solar set-asides may raise Commerce Clause concerns as discussed in the preceding section. However, functional eligibility requirements such as in-state deliverability or power displacement may accomplish nearly the same results as location requirements. As a practical matter, the majority of DG or solar projects that are capable of meeting RPS functionality requirements will also be located in-state.

At the same time, because deliverability requirements for DG or solar set-asides mean that the provisions disproportionately benefit in-state projects, it might be argued that even neutral functional eligibility requirements impermissibly burden commerce by foreclosing opportunities for out-of-state generation. Since functional requirements are neutral, the *Pike* balancing test would apply to evaluate these particular Commerce Clause issues.

DG or solar set-asides impose minimal burdens on commerce since they comprise only a small percentage of utilities' RPS obligations. The minimal burdens to commerce are also offset by states' compelling interest in DG set-asides as a way to meet legitimate state goals such as improved reliability and diverse supply. Without DG set-asides, a state has few alternatives to ensure that utilities will use DG or solar resources to comply with the RPS because utilities are more inclined to favor larger or lower cost renewable projects to meet their RPS obligations. Set-asides compel utilities to incorporate DG or smaller projects into their renewables mix.

There are really no comparable alternatives by which a state can accomplish legitimate policy goals underlying DG or small solar set-asides such as reliability, diversity of supply or avoidance of new transmission (which in turn serves environmental goals). Even providing state funding for DG to reduce the cost will not necessarily result in the integration of DG into a utility's energy portfolio. The compulsory nature of RPS programs drives utility adoption of DG more effectively than any other incentive.

Given the minimal burden to commerce occasioned by set-asides, strong state interest, and lack of alternatives to achieve state goals, functional based eligibility requirements for DG set-asides will likely pass muster under the Commerce Clause.

4. Limits on out-of-state RECs

A renewable energy credit represents the environmental attributes of a renewable energy project, and may be conveyed separately (unbundled) from sale of project power. RECs are also viewed as a financing tool because they supply projects with another stream of revenue in addition to revenue from power sales.

An RPS program may allow utilities to satisfy their compliance obligation through a combination of eligible renewable electricity purchases and unbundled RECs. Programs that limit the percentage of a utility's RPS obligation which can be satisfied with unbundled RECs without regard to the REC's point of origin are facially neutral and do not violate the Commerce Clause. By contrast, programs that allow a utility to satisfy its full RPS compliance requirements with in-state RECs, but preclude or limit use of out-of-state RECs for compliance, are facially discriminatory.

Prohibiting use of out-of-state, but not in-state unbundled RECs for RPS compliance obligation is problematic under the Commerce Clause. Differential treatment is always suspect under the Commerce Clause, and a state's reasons for favoring in-state RECs are likely to be viewed as protectionist: a way to drive up the value of in-state RECs and produce a revenue stream to subsidize development of in-state projects. Moreover, states have alternatives: they may award grants directly to in-state projects, or impose more neutral restrictions – i.e., restricting use of RECs associated with those projects that do not deliver power into the state.

II. Options for States

There are many ways for states to implement RPS programs that do not implicate Commerce Clause concerns. This section provides options for states to ensure that existing RPS laws enable them to retain and capture in-state benefits in a constitutionally compliant manner.

1. Craft facially neutral eligibility requirements

RPS programs that contain neutral RPS eligibility requirements stand the best chance of avoiding Commerce Clause problems. Eligibility requirements based on functional criteria such as a project's ability to interconnect to in-state distribution facilities, deliver power in-state or displace power that would otherwise have been delivered in-state are all likely to survive Commerce Clause scrutiny. RPS programs that grant enhanced compliance credit for certain types of renewable resources are also permissible because they do not discriminate based on location.

2. Choose carefully the technologies that are eligible for the RPS based on state resources

States often express preference for in-state resources through their resource eligibility rules. Provided the eligibility resource definitions are facially neutral (not expressly location-based), a state certainly may include or exclude resources based on the relative abundance or lack of the resource in-state. For example, a state such as Ohio is justified in not including ocean–based technologies in its list of eligible resources because it lacks ocean waters, even though it may be part of a power pool that includes coastal states. In contrast, New Jersey may (and has) adopted a requirement for 1,100 MW of offshore wind that is connected to the New Jersey electric transmission system, based on the abundance of this wind resource off its coast, without a Commerce Clause risk.[36]

There are many examples in which states have selected particular RPS resources for eligibility based on their desire to increase the use of those resources in which the state is well-endowed, without implicating the Commerce Clause since the requirement is open to in and out-of-state resources, regardless of location. For example, Maryland, which produces 325,000 tons of chicken manure each year, includes poultry litter in its list of eligible Tier 1 resources[37], and North Carolina, with about 10 million pigs each

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[36] NJ S.B. 2036 (08/19/2010)

[37] Md. Public Utility Companies Code § 7-701 et seq. (05/26/2004) (subsequently amended)

year, requires 0.2% of electricity to be generated from swine waste by 2018[38], because these requirements are facially neutral. And Connecticut, home to a large manufacturer of fuel cells, includes fuel cells (using renewable or non-renewable fuels) in its Class I requirement.

Similarly, a state may also exclude certain resources such as large hydropower because the state does not want to support conventional technologies or has concerns about the technology's environmental impacts. This type of exclusion affects both out-of-state and in-state resources.

3. Focus on legitimate state goals such as environmental protection, reliability, energy conservation and diversity of supply and safety

Even where a facially neutral state statute affects commerce, the state's interest in legitimate goals such as environmental protection (either in emissions reduction or, with DG, by minimizing the need to construct additional transmission), reliability, energy conservation and diversity of power supply will outweigh any incidental burdens to commerce under the *Pike* balancing test. Thus, states should incorporate these goals prominently in the enabling language of any RPS programs. Economic development or establishment of an indigenous renewables industry, while laudable, are more likely to be viewed by courts as economically protectionist goals which do not justify a burden on commerce.

4. Evaluate feasibility of re-casting location-based requirements in a facially neutral manner

States should consider whether a location-based requirement can be recast in more neutral terms. As discussed, with regard to DG set-asides, there is not much difference between a functional eligibility requirement based on a project's ability to interconnect to a distribution facility or deliver power in-state and an in-state location requirement. As a practical matter, most of the DG projects that can meet a deliverability (or displacement) requirement will be located in-state since it is neither economic or desirable for out of state DG projects (particularly those that are consumer owned or behind the meter) to pay the added costs associated with interconnecting in another state.

To the extent that a location-based preference can be expressed in neutral terms, it stands a better chance of surviving Commerce Clause scrutiny.

[38] N.C. Gen. Stat. § 62-133.8 (8/20/2007)

5. Consider regional location requirements rather than in-state location requirements

As a practical matter, regional location requirements, although still somewhat problematic under the Commerce Clause, are less likely to attract a challenge simply because they are far less restrictive than in-state location requirements. Moreover, while there are a myriad of Supreme Court cases overturning in-state location requirements on Commerce Clause grounds, there are no cases that specifically address the constitutionality of in-region location requirements.[39] For these reasons, an in-region location requirement, while not free of constitutional concerns, offer a less risky approach to RPS eligibility than in-state location requirements.

6. Build a record showing that the state lacks alternatives to achieve legitimate goals

States that employ location-based RPS requirements may be able to insulate their programs from a successful challenge by building a legislative or administrative record showing that the state lacks non-discriminatory alternatives to achieve its goals of reliability, power diversity or avoiding environmental harm associated with new transmission. Thus, a state enacting a location-based DG set-aside might include in the legislative or administrative record expert testimony, studies and reports showing that alternatives to a location-based requirement are infeasible -- for example, that deliverability requirements would exclude entities producing behind-the-meter generation, and that displacement requirements are infeasible alternatives because they are difficult to track and verify.

In addition, states should downplay the economic development advantages of location-based RPS eligibility requirements and focus more on goals such as reliability, diversity and environmental health. Admittedly, downplaying the in-state economic benefits for RPS programs may not be politically feasible since legislators seek to justify the economic costs of RPS programs. But focusing on non-economic goals such as reliability or environment will neutralize claims that a location-based RPS requirement is driven by economic protectionism, which the Commerce Clause prohibits.

7. Limit rather than prohibit use of unbundled out-of-state RECs for compliance to reduce litigation risk

States face the greatest challenge in restricting or prohibiting use of unbundled out-of-state RECs for RPS compliance, while not similarly constraining use of in-state

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[39] But see, *Hunt v. Washington State Apple*, 432 U.S. 333, *supra* n.13 (striking down law that has the effect of barring apple sales from some but not all states). *Hunt* did not specifically address regional restrictions.

RECs. Disparate treatment of unbundled RECs for RPS compliance would likely be viewed as a protectionist measure to subsidize in-state development, and vulnerable under the Commerce Clause.

The market-participant exception might offer an option for limiting or restricting use of out-of-state RECs -- but only if states themselves purchase RECs to become active participants in the market. Otherwise, the next best option is for states to limit the number of out-of-state RECs that a utility can use for compliance. While limitations on use of out-of-state RECs are facially discriminatory and thus constitutionally vulnerable, as a practical matter, out-of-state companies may have less incentive to bring a challenge if they are still able to satisfy a portion (albeit reduced) of the RPS requirement using out-of-state RECs.

8. Minimize risk of litigation by phasing in requirements gradually

States implementing or amending RPS programs that favor in-state development should do so in a way that minimizes the impacts on affected entities and reduces the risk of a challenge. As described in the Appendix, Massachusetts' adoption of an in-state location requirement for its solar carve-out program increased TransCanada's compliance costs. TransCanada had already locked into contracts which did not qualify for Massachusetts' new in-state RPS eligibility requirements and would have faced enhanced compliance penalties under the new law. By raising a Commerce Clause challenge to Massachusetts' program, TransCanada was able to leverage a settlement that enabled it to avoid added compliance costs.

Bringing a constitutional challenge to an RPS program is a potentially expensive proposition. Unless a company such as TransCanada that has substantial dollars at stake, a suit may not be cost effective for most affected parties. Phasing in new RPS requirements to avoid cost-shock to impacted entities will not cure underlying constitutional infirmities, but it will reduce the risks of litigation.

9. Assess Risks

States can take some comfort that many of these RPS laws have "been on the books" for years without being subject to challenge. The Massachusetts case is unusual in that the in-state requirements precluded a large and well funded out-of-state competitor from competing for, and gaining access to, the Massachusetts market which in turn gave rise to the lawsuit. In most other situations, statutes have gone unchallenged either because companies are resource constrained, or because an RPS program limits, but does not entirely foreclose a company from availing itself of an RPS program.[40]

[40] However, it should be noted that recently a California utility, Southern California Edison Company (SCE), filed a rehearing challenge to the California Public Utilities Commission's decision of January,

At the same time, lingering constitutional questions may create uncertainty even if the actual chances of a lawsuit are minimal. For that reason, states may want to reevaluate their programs and implement some of the options described in this Report.

2011, arguing that certain REC-related elements of the California RPS program violate the Commerce Clause. In a February, 2011 filing with the Commission, SCE alleges that, among other legal defects, the Commission has placed limitations on the use of REC-only transactions that limit the availability of out-of-state RPS procurement in violation of the Commerce Clause. In its administrative challenge, SCE states that it reserves its rights to raise the Commerce Clause claims in federal court, if necessary. *See* Application of Southern California Edison Company for Rehearing of Decision 11-01-025, CPUC Rulemaking 06-02-012 (Filed February 14, 2011).

APPENDIX

Case Study of Commerce Clause Challenge to Provisions of the Massachusetts Green Communities Act

In 2008, the Massachusetts General Assembly passed the Green Communities Act, updating the state's RPS. Among other things, the Green Communities Act requires the Massachusetts Department of Public Utilities (DPU) to adopt rules to implement long-term contracts for renewable energy in order to "facilitate the financing of renewable energy generation within the jurisdictional boundaries of the [C]ommonwealth, including state waters, or in adjacent federal waters."[41]

In June 2009, the DPU adopted rules for long-term contracts for renewable energy.[42] Each distribution company was required to solicit proposals from renewable energy developers, and, if reasonable proposals have been received, to enter into long-term (10-15 years) contracts for the energy or RECs to facilitate financing of in-state projects.[43]

Under the initial rules, long-term contracts had to be with renewable energy generation sources that:

(1) have a commercial operation date on or after January 1, 2008;

(2) are certified by the state as eligible to participate in the RPS, and to sell RECs under the program;

(3) are determined by the DPU to

   (a) provide enhanced electricity reliability within Massachusetts;
   (b) contribute to moderating system peak load requirements;
   (c) be cost-effective to Massachusetts electric ratepayers over the term of the contract; and

(4) are a cost-effective mechanism for procuring renewable energy on a long-term basis.[44]

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[41] G.L. c. 169, § 83.

[42] Massachusetts Department of Public Utilities, Order Adopting Regulations. Docket 08-88-A, June 12, 2009. Appendix A. 220 CMR 17.00.

[43] "In-state" includes state and adjacent federal waters (see Massachusetts Long-Term Contracts Case Study).

[44] 220 CMR 17.05

In December 2009, the DPU approved the method and timetable for the solicitation;[45] the utilities issued their RFP in January 2010. Proposals had been received and the review process was underway when, on April 16, 2010, TransCanada Power Marketing Ltd. filed a lawsuit in federal court alleging that limiting eligibility for long-term contracts to in-state projects violates the Commerce Clause of the U.S. Constitution.

On June 1, 2010, TransCanada also sought an injunction to prevent the signing or approval of contracts under the state-sponsored RFP. On June 9, the DPU suspended the requirements that (1) renewable energy generation sources be located within the jurisdictional boundaries of Massachusetts, and (2) where feasible, additional employment be created "in the [C]ommonwealth."

Soon after, the DPU issued emergency rules to allow solicitations for long-term contract proposals for renewable energy generation from outside Massachusetts.[46] These emergency rules removed all in-state preferences for renewable energy projects. The rules were made final on August 20, 2010.

As part of the emergency rules, the DPU also directed the utilities to work with the Department of Energy Resources (DOER) to revise the RFP. [47] In July, the DPU invited comments on the utilities' proposed changes.[48] Following comments and responses from the parties, the DPU approved the RFP.[49] The revised and amended RFP included the following changes (among others) to the original RFP:

- The requirement that the renewable energy generation source be "within the jurisdictional boundaries of the commonwealth, including state waters, or in adjacent federal waters" has been eliminated

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[45] Massachusetts Department of Public Utilities, Joint Petition by Fitchburg Gas and Electric Light Company d/b/a Unitil, Massachusetts Electric Company and Nantucket Electric Company d/b/a National Grid, NSTAR Electric Company, Western Massachusetts Electric Company, and the Commonwealth of Massachusetts Department of Energy Resources for approval of proposed timetable and methods for the solicitation and execution of long-term contracts for renewable energy, pursuant to St. 2008, c. 169, § 83. Docket 09-07, December 29, 2009.

[46] Massachusetts Department of Public Utilities, Order Adopting Emergency Regulations. Docket 10-58, June 9, 2010.

[47] Massachusetts Department of Public Utilities, Notice of Filing and Request for Comments. Docket 10-76, July 19, 2010.

[48] *Id.*

[49] Massachusetts Department of Public Utilities, Corrected Order. Docket 10-76, August 27, 2010.

- The requirement that the renewable energy generation source "create employment, where feasible," is no longer limited to Massachusetts
- Bidders must disclose, and the utilities must consider, whether entering into long-term contracts will facilitate the financing of the project
- Bidders bear the costs associated with delivering the energy and/or RECs, and utilities are required to evaluate the estimated market value of energy, RECs, and capacity, taking into consideration the production profile and location of the proposed project over the term of the proposed bid
- The utilities will evaluate bids and negotiate long-term contracts independently, not jointly or in consultation with DOER

On September 2, 2010, the Massachusetts utilities (National Grid, NSTAR Electric, Western Massachusetts Electric and Fitchburg Gas & Electric) issued an amended RFP. In addition to accepting bids from out-of-state projects, the solicitation allowed new in-state bidders to participate and allowed bidders that submitted bids previously under the first RFP to refresh their bids. Bids were due on October 7, 2010. The results of the bids—and in particular, whether the selected bids include any out-of-state projects—are unknown as of this writing.

The conclusion to the legal process has been postponed because a stay in the proceeding was granted at the request of both parties until May 2011, presumably to give the solicitation process time to play out.

The TransCanada suit also involved another provision of the Massachusetts RPS. When the Massachusetts legislature adopted the Green Communities Act, it directed the Department of Energy Resources to establish a requirement that a minimum percentage of electricity sales be from "new on-site renewable energy generating sources located in the commonwealth."[50] DOER first proposed emergency rules for a 400 MW solar set-aside. To be eligible, solar generation units must be "used on-site, located in the Commonwealth of Massachusetts, and be interconnected with the electric grid."[51]

The solar alternative compliance payment (ACP) was set at $600, but DOER then lowered the ACP for retail electricity suppliers that already had fixed-price contracts with customers. As initially proposed, the emergency rules established that the solar ACP for contracts entered into prior to January 1, 2010 would be $400 per MWh for compliance year 2010 rising to $500 per MWh for compliance year 2012. This was

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[50] Green Communities Act S.B. 2768, Section 11F. (g)

[51] 225 CMR 14.05 (4). As distinguished from the solar carve-out, the Massachusetts Class I requirement may be satisfied with behind-the-meter generation that is located within the ISO-NE control area; off-grid generation may be eligible only if it is located in Massachusetts.

amended to $325 per MWh for the duration of pre-existing retail load contracts because of comments by several retail electricity suppliers that they would not be able to recover the solar ACP from existing customers already under contract at pre-negotiated prices.[52]

Subsequently, on April 16, 2010, TransCanada Power Marketing filed its lawsuit in Federal District Court in Massachusetts, described above. The lawsuit also included a challenge to the in-state solar requirement. TransCanada asserted in its complaint that, "[w]ere it not for the discriminatory requirement TransCanada would purchase Solar RECs at lower prices from out-of-state generators – both this year and in the future as the broader market develops – which would obviate the need for TransCanada to purchase Solar RECs at high prices from Massachusetts generators, or else make expensive Alternative Compliance Payments."

A few weeks later, the parties to the suit reached a partial settlement with respect to the solar carve-out requirements. In the settlement agreement, DOER agreed to charge the Class I alternative compliance payment for that portion of a retail supplier's load obligation that was contracted before January 1, 2010. Load obligations that were contracted on or after January 1, 2010, would be subject to the higher solar alternative compliance payment proposed in the emergency regulations.[53] In other words, the solar obligation, including the in-state requirement, applies to a supplier's total load, but the new solar ACP will apply only to that portion of load that is contractually committed or renewed beginning in 2010. The in-state requirement remains in place.

The Massachusetts case just described is not an anomaly. In December 2010, TransCanada and a coalition of business groups filed suit in Massachusetts Supreme Judicial Court and challenged the constitutionality of the same procurement statute, this time in the context of the Massachusetts Department of Public Utilities' approval of a power purchase agreement (PPA) between Cape Wind and National Grid.[54]

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[52] 225 CMR 14.08 (3) (b) 3. "The ACP Rate for that portion of a Retail Supplier's obligation under contracts entered into prior to January 1, 2010, shall be $400 per MWh for Compliance Year 2010, $450 per MWh for Compliance Year 2011, and $500 per MWh for Compliance Year 2012." This was changed to: "The ACP Rate for that portion of a Retail Supplier's obligation under contracts executed prior to January 1, 2010, shall be $325 per MWh for the duration of such contracts. This provision does not apply to contracts extended on or after January 1, 2010."

[53] 225 CMR 14.08 (3) (b) 3. Changed to: The ACP Rate for that portion of a Retail Electricity Supplier's Solar Renewable Energy Credit obligations that were contractually committed or renewed prior to January 1, 2010, shall be equal to the RPS Class I ACP Rate as calculated for the applicable Compliance Year under 225 CMR 11.08(3)(a)(2). This provision does not apply to obligations that were contractually committed or renewed on or after January 1, 2010. [same language as the settlement agreement]

[54] *TransCanada Power Marketing v. Department of Public Utilities*, Supreme Judicial Court Massachusetts, Docket No. SJ-2010-0537 (December 13, 2010).

TransCanada argued that the DPU erred in approving the contract because National Grid was required to implement a competitive bidding process pursuant to G.L. c. 169, Section 83 ("Section 83") and failed to do so. TransCanada also contended that the competitive bidding process violated the Commerce Clause because it was not open to out-of-state entities – and that the DPU's June 9 order lifting the ban on out-of-state participation in utilities' procurement process "did not remove the taint" of the Commerce Clause violations because the order came too late to enable TransCanada to compete. Following a briefing of the issues, the court took the case under advisement on February 4, 2011, with a decision pending.

In addition, TransCanada has raised Commerce Clause concerns in Rhode Island regarding power purchase agreements, although within a regulatory proceeding rather than in a court case.[55]

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[55] *Review of Amended Purchase Power Purchase Agreement Between Narragansett Electric d/b/a National Grid and Deepwater Wind Block Island, LLC Pursuant to R.I.G.L § 39-26.1-7*. Rhode Island Public Utilities Commission, Docket No. 4185 (TransCanada Motion to Dismiss and Memorandum in Support of Motion to Dismiss, dated July 13, 2010).

Clean Energy States Alliance (CESA) is a national nonprofit coalition of state clean energy funds and programs working together to develop and promote clean energy technologies and markets. CESA provides information sharing, technical assistance services and a collaborative network for its members by coordinating multi-state efforts, leveraging funding for projects and research, and assisting members with program development and evaluation.

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