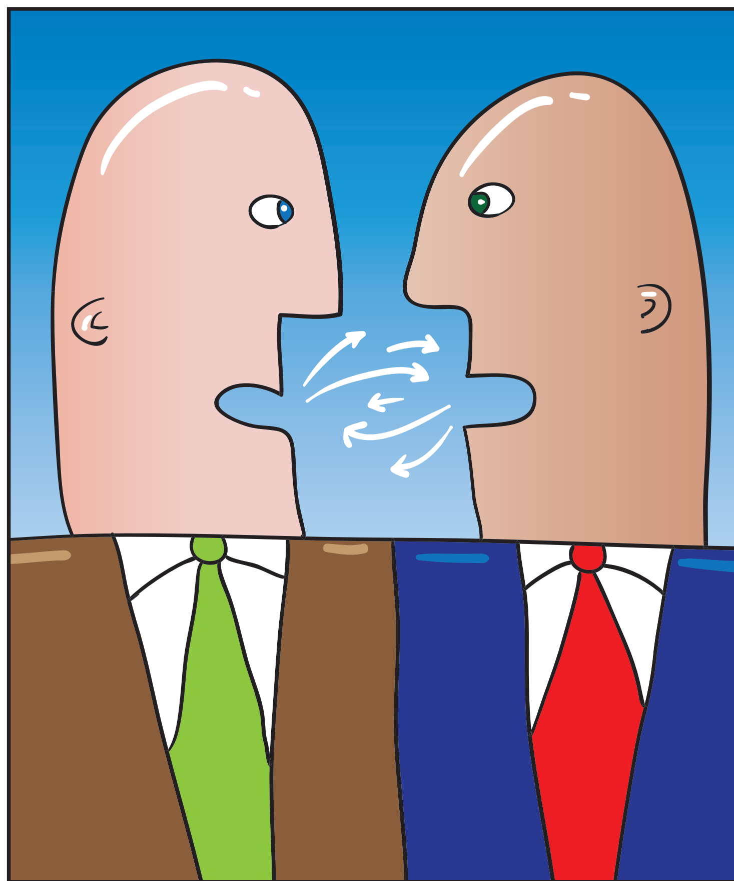
Commerce Clause Conflict



In-state green mandates face Constitutional challenges.

By Richard Lehfeldt, Woody N. Peterson, and David T. Schur

assachusetts wanted renewable power—lots of it, and sooner rather than later.

So it established cutting-edge energy efficiency standards. It enacted tax incentives for qualifying biofuels and low-carbon fuels. It adopted California's vehicle standards—the most stringent in the nation. It developed, in conjunction with other New England states, a climate change action plan. It joined the Regional Greenhouse Gas Initiative (RGGI), a multi-state emission cap-and-trade program. It established industrial emission targets. It devised an aggressive renewable portfolio standard (RPS) requiring its utilities to use significantly more renewable power to meet load requirements.

So far, so good—these efforts were praised by both the environmental community and the burgeoning alternative energy and energy efficiency industries.

But then Massachusetts enacted the Green Communities Act (GCA) in 2008 to foster the development of new renewable power plants within the Commonwealth.[1] One of the ways the GCA tried to do this, in Section 83, was to require Massachusetts electric distribution companies to enter into long-term power purchase agreements (PPAs) with renewable power companies located "within the jurisdictional boundaries of the Commonwealth."

This latest Massachusetts initiative didn't trigger kudos, but instead condemnation in the form of a lawsuit by TransCanada Power Marketing Ltd. An established competitive power company with numerous renewable power projects either completed or under development throughout New England,[2] TransCanada filed a lawsuit attacking what TransCanada called Massachusetts' "home-grown" preference in GCA Section 83.[3] TransCanada's prime target was the Commonwealth's 2010 request for proposals (RFP) that only allowed the submission of proposals from projects located in Massachusetts. TransCanada says the GCA discriminates against out-of-state renewable generation facilities that are physically and functionally indistinguishable from in-state facilities, in violation of the Commerce Clause of the United States Constitution, under the so-called Dormant Commerce Clause doctrine.[4]

The Massachusetts litigation brings into sharp focus a potential conflict between states seeking to maximize development of in-state renewable power resources and the legitimate objectives of the competitive power industry, which has been responsible for the development and operation of most of the nation's renewable power resources to date. Can these two legitimate but conflicting objectives be harmonized?

Considering the types of incentives currently available to renewable power development, and the Dormant Commerce doctrinal law against that landscape, some answers emerge that might allow states to reduce the tension between these two sets of legitimate objectives—and prevent a Constitutional challenge.

Commerce Clause attacks on RFPs pose a potential threat to states' ability to meet their renewable portfolio objectives.

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Renewable Power Growth

Development of most electric power resources has slowed in recent years, but not renewable power. That resource, long just a figment of science fiction writers' and idealists' imaginations, today is a welcome reality. In 2009, in the midst of the worst economic climate since the Great Depression, the American wind industry installed nearly 10,000 MW of new generating capacity.[5] Renewable power will continue to play—and some would say must continue to play—a leading role in America's energy and climate policies.

Important and essential as that role will be, filling it will be neither easy nor cheap. The electric power sector is the most capital-intensive industry in the world, and renewable power plants are expensive to construct. Although the cost of renewable power plants should continue to fall in absolute terms as more plants are built—and will fall also in relative terms once carbon costs are included in the nation's resource choices—the cost of building a utility-scale renewable plant today typically ranges from hundreds of millions to billions of dollars.

On top of that, renewable power development today involves complex, confusing, and overlapping skeins of preferences, tax incentives, and mandates. At the federal level, these include the investment tax credit, the production tax credit, various grant and loan guarantee opportunities, the regulatory exemptions available since 1978 under PURPA,[6] and the steroidal benefits provided by the Stimulus Act,[7] which are time-limited but provide in some instances cash-equivalent Treasury grants for up to 30 percent of the capital cost of a renewable power project.

Twenty-nine states and the District of Columbia each have

adopted an RPS that mandates the development of renewable power resources. The 30 pieces of this regulatory puzzle have only one thing in common: a legal requirement that jurisdictional utilities within the state have a certain percentage of renewable power within their generation portfolios by a date or dates certain. Everything else in the programs differs dramatically, and in every conceivable way. For example:

- What resources qualify as "renewable" under state law;
- What portfolio percentages are mandated, and by when;
- Whether there are "set-asides" for certain favored technologies;
- Who (as between the utilities themselves and third-party providers) will be expected to build these resources;
- The compliance and enforcement regimes established to ensure adherence to the mandates; and
- How to deal with cross-border sales of renewable power—and the renewable energy credits associated with renewable power resources.

The U.S. Congress has tried, and to date failed, to enact a federal RPS law that would end this balkanized regime and replace it with a unitary, national template.

States have begun to address the material costs associated with these requirements—including the necessary ancillary capital expenditures, such as new transmission lines and supplementary generation to balance intermittent resources such as solar and wind power—with the limited arsenal of regulatory and financial tools available to the sector as a whole. With the filing of the TransCanada suit, the question has become whether the Dormant Commerce Clause might limit the states' ability to utilize some of these tools.

The Dormant Commerce Clause

As more than one court has noted with exasperation, "[h]armonizing the guidance set out in the Supreme Court's many dormant Commerce Clause opinions is not a simple task."[8]

A few principles, however, can readily be derived. The threshold question in any Dormant Commerce Clause inquiry is: Does the law discriminate? In this context, "discrimination simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."[9] Examples of state laws that discriminate are those that prohibit out-of-state direct shipment of wine into the state, but allow in-state shipments,[10] grant tax credits only for ethanol produced in a particular state,[11] and require electric utilities to use coal produced in that state.[12]

If the law "discriminates" within the meaning of the Dormant Commerce Clause, then it's subject to strict scrutiny and will be upheld only if it "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives."[13] This is a difficult standard to satisfy. Indeed, "[s]tate laws that discriminate against interstate commerce face a virtually *per se* rule of invalidity."[14] Facially discriminatory laws are routinely struck down, and generally have been upheld only in the very narrow quarantine context, where the very movement of articles in interstate commerce risks imminent contamination and disease.[15]

If there is no "discrimination," however, then the much more forgiving balancing test of *Pike v. Bruce Church, Inc.*[16] applies. The *Pike* test is "reserved for laws directed to legitimate local concerns, with effects upon interstate commerce that are only incidental."[17] Under this test, a court will uphold a nondiscriminatory statute "unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits."[18] State laws frequently survive *Pike* scrutiny,[19] though not always, as in *Pike* itself.[20]

There are two exceptions to these principles by which a seemingly discriminatory law can pass Dormant Commerce Clause muster. The first is the "market participant" exception. If the state is acting as a "market participant" rather than a regulator, discrimination is permissible.[21] Thus, for example, a state-owned cement plant can give preference to in-state customers without running afoul of the Dormant Commerce Clause.[22] The second is the "public entity" exception, whereby discrimination is permissible if it favors public entities while treating in-state and out-of-state private entities the same.[23]

Harmonizing the Supreme Court's Dormant Commerce Clause guidance is difficult enough in traditional contexts. It is even more so in the context of renewable power plants.

At first glance, the analysis seems straightforward enough: a power plant is a factory—a big, expensive one, but a factory all the same—that from the outside looks much like any conventional factory.

A power plant, like all factories, is a large-scale economic engine. Factories create construction jobs, permanent jobs, multiplier-effect jobs that ripple through a local economy, and long-term tax revenues. State and local governments must either embrace or tolerate the development of factories in order for them to get built. Indeed, public entities often go even farther and compete against one another, utilizing a mix of grants, tax holidays, and other incentives to persuade the owners of auto plants, baseball parks, and green technology factories to build

Facially discriminatory laws are routinely struck down, and generally have been upheld only where interstate commerce risks imminent contamination.

them in their state. None of these economic incentives would appear to implicate the Commerce Clause. The decision by State A to allow construction of a factory in State A doesn't give rise to a complaint under the Commerce Clause from State B for failure to construct the factory in State B; a factory has to be built somewhere, and the ultimate choice of a site doesn't, on its own, interfere with interstate commerce.

The Dormant Commerce Clause doctrine is potentially implicated, however, with regard to the plant's products. If a power plant is a factory, its product is electricity. Electricity is in many ways a commodity like tangible products such as milk, phosphates, and alcohol. It flows in interstate commerce pursuant to the laws of physics, regardless of its buyers' and sellers' intentions, regulatory compacts, or contractual arrangements. While the end product (electrons) is fungible, there's considerable variety in the sources of that end product (coal, geothermal, etc.). Power plants, whether developed under traditional utility cost-of-service ratemaking, or through long-term PPAs between a utility and a developer, involve the dedication of resources to serve a load, but the plant's electrons can be sold and resold, at wholesale or in some instances across state lines, into a regional pool, or even across regions, so long as transmission capacity and economics are capable of supporting the sale.

Finally, most power plants have significant byproducts, including solid waste and air emissions. Most of these byproducts are subject to comprehensive regulatory regimes administered by the U.S. Environmental Protection Agency, with much of that authority delegated to the states for implementation. Indeed, a major aspect of states' quest for renewable power is the desire to avoid or displace power plants with significant emission profiles (*e.g.*, coal) and to replace them with resources that have minimal emissions (*e.g.*, wind or solar facilities). The Commonwealth of Massachusetts and numerous other states have indicated clearly that these emissions are a critical component of their resource decisions, *i.e.*, that it matters to them what fuel creates their electricity. That public policy choice—reflected, as noted, throughout Massachusetts' energy and environmental policy—suggests a colorable state defense against a dormant Commerce Clause attack, based on "a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives."[24]

Programs that involve building in-state power plants can thus simultaneously trigger scrutiny under two aspects of Dormant Commerce Clause case law: state programs that provide significant benefits to develop in-state resources or to keep such resources in-state (*see New England Power Co. v. New Hampshire, 455 U.S. 331, 344 (1982), striking down state law prohibiting out-of-state export of hydroelectric power*), and state programs that seek to keep out articles of commerce that the state wants no part of, such as garbage (*see Philadelphia v. New Jersey, 437 U.S. 617, 628 (1978), striking down state law prohibiting importing trash collected out-of-state*).

Harmonizing Objectives

States haven't waited for Congress to enact a federal RPS standard. Those that have already established their own RPS programs have set their sights on a major shift in the fuels America uses to make its electricity. That shift will require new infrastructure, which will in turn require significant capital and involve significant financial risk for companies that want to build it. And companies will have to finance these projects at a time of unprecedented capital constraint.

The electricity industry has existed for more than a century, but stills relies chiefly on only two financing mechanisms to pay for its larger infrastructure needs: utility rate-basing and long-term PPAs between a power project and a load-serving utility that provide the foundation for project financing. The challenged GCA Section 83 relies on the latter. Section 83 requires in-state regulated utilities—the only ones over which the Commonwealth has legal authority—to buy their renewable power only from in-state facilities under long-term PPAs.

A state is least vulnerable to Commerce Clause assault when it makes explicit the incentives it's offering.

Under current economic conditions, executed PPAs are necessary for sponsors to obtain project financing of non-utility facilities. Commerce Clause attacks on RFPs for new renewable power resources accordingly pose a potential threat to states' ability to meet their renewable portfolio objectives, to make resource decisions outside the purview of the organized markets, to participate proactively in environmental markets such as RGGI, and to develop in-state assets that are ready to compete in the emerging green economy. Without executed PPAs capable of defeating Commerce Clause attacks, these resources, if developed at all, will instead be developed outside the competitive process, most likely by traditional utilities. That outcome, ironically, would be the exact opposite of what TransCanada seeks in its lawsuit against Massachusetts.[25]

What, then, can a state do to inoculate itself against such attacks? To begin with, the state should approach the development of these power plants much as it approaches more traditional economic development: by making explicit at the outset the incentives it's offering to convince developers to build facilities in the state. The opportunity to enter into a long-term PPA should be one of the benefits offered to successful bidders as part of the state's development initiative, not the starting point. As noted above, the state is on its firmest ground, and

least vulnerable to Commerce Clause assault, when approaching economic development in this way. Massachusetts is by no means the only jurisdiction that views the development of green businesses within its borders as not just an environmental objective, but a business opportunity that the state can make attractive, if not impossible to resist, by offering financial incentives to a company if it chooses to build the plant within its borders.

Second, the state should highlight the specific reasons why it seeks to develop a particular resource at a unique site. For example, from a Commerce Clause vantage point, it's wholly appropriate for a state to take steps to solicit companies to develop power plants at either brownfield sites within its borders, or offshore wind resources in the waters off its coastline within its jurisdiction. So long as these objectives are explicit and transparent, the state should be able to defend against arguments such as those made by TransCanada that there is no functional difference between a power plant in an adjoining state, and a power plant that Massachusetts is seeking to develop within the Commonwealth.

Finally, the state, in encouraging in-state development, should make explicit the environmental objectives and benefits of clean in-state generation. While electrons are fungible, the byproducts of the power plant factory (solid waste, air emissions, etc.) are not. A state that seeks new in-state renewable power plants may increase its reserve margins, improve its air quality, displace fossil-fuel based generation, avoid transmission congestion charges that may apply, and may also avoid or defer the need to build new transmission lines. All of these are defensible state policy objectives that can serve to defend against dormant Commerce Clause attacks.

The nation's emerging commitment to renewable power is in its early stages. With or without a national consensus on climate change, a resource shift of this magnitude hits many of the major fault lines in the nation's complicated energy policy: fuel choice, the costs and benefits of environmental improvement, the tension between federal and state authority over these decisions, and the unresolved national debate between a monopoly regulatory model and a competitive alternative. The TransCanada litigation is but one forum to begin to address issues that are more typically taken up by legislatures. Despite the murky judicial history of the Dormant Commerce Clause doctrine, there should be room for the court to resolve the collision in this suit between two meritorious social objectives: environmental improvement and fair competition.

Endnotes:

1. 2008 Mass. Acts c.169.
2. *TransCanada Power Marketing Ltd. v. Bowles*, Civil Action No. 4:10-CV-40070-FDS (D Mass., filed Apr. 16, 2010) ("Complaint").
3. Complaint at p. 15.
4. The Commerce Clause gives Congress the power "to regulate commerce . . . among the several States." U.S. Const. art. I, § 8, cl. 3. The "Dormant Commerce Clause" doctrine is a judicially constructed negative corollary of the Commerce Clause that essentially "prevents a State from jeopardizing the welfare of the Nation as a whole by placing burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear." *Am. Trucking Ass'ns v. Michigan Pub. Serv. Comm'n, 545 U.S. 429, 433 (2005) (quoting Oaklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 180 (1995)).
5. American Wind Energy Association Year End 2009 Market Report (Jan. 2010)
6. The Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §§ 2601-2645.
7. The American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009).
8. *Am. Bus Ass'n. v. District of Columbia*, [2 A.3d 203]; [2010 D.C. App. LEXIS 493] at *25 (D.C. 2010).
9. *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth*., 550 U.S. 330 (2007) (internal quotation marks omitted).
10. *See Granholm v. Heald*, 544 U.S. 460 (2005).
11. *See New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988).
12. *See Wyoming v. Oklahoma*, 502 U.S. 437 (1992).
13. [Granholm, 544 U.S. at 489.]
14. *Id.* at 476 (internal quotation marks omitted).
15. *See City of Philadelphia v. New Jersey*, 437 U.S. 617, 628-629 (1978) ("[C]ertain quarantine laws have not been considered forbidden protectionist measures, even though they were directed against out-of-state commerce… [T]hose quarantine laws banned the importation of articles such as diseased livestock that required destruction as soon as possible because their very movement risked contagion and other evils. Those laws thus did not discriminate against interstate commerce as such, but simply prevented traffic in noxious articles, whatever their origin.") (*citing Asbell v. Kansas, 209 U.S. 251 (1908), Reid v. Colorado, 187 U.S. 137 (1902), Bowman v. Chicago & N. W. Ry. Co*., 125 U.S. 465 (1888)).
16. 397 U.S. 137 (1970).
17. *United Haulers*, 550 U.S. at 346 (internal quotation marks omitted).
18. *Id.* (internal quotation marks omitted).
19. *See, e.g., Id. at 346-47*; [*Nw. Cent. Pipeline Corp. v. State Corporation Comm'n of Kansas*, 489 U.S. 493, 525- 526 (1989) (upholding under *Pike* a state regulation which provided that the right to extract natural gas would be forfeited if production was delayed too long); *Minnesota v. Clover Leaf Creamery Co*., 449 U.S. 456, 472-474 (1981) (upholding under *Pike* a state law prohibiting sale of milk in certain plastic bottles).
20. *See Pike*, 397 U.S. at 146 (striking down state law that required all state-grown cantaloupes to be packaged within state prior to export).
21. *See generally Department of Revenue of Kentucky v. Davis*, 553 U.S. 328 (2008) ("Some cases run a different course, however, and an exception covers States that go beyond regulation and themselves participat[e] in the market so as to exercis[e] the right to favor [their] own citizens over others. . . . This market-participant exception reflects a basic distinction ... between States as market participants and States as market regulators,. . . [t]here [being] no indication of a constitutional plan to limit the ability of the States themselves to operate freely in the free market.") (internal quotation marks omitted) (alterations in *Davis*).
22. *Reeves, Inc. v. Stake*, 447 U.S. 429, 436-46 (1980).
23. *See, e.g., United Haulers*, 550 U.S. at 343 (upholding "flow control" ordinance requiring trash haulers to deliver solid waste to a processing plant owned and operated by a public authority); *Davis*, 553 U.S. at 343 (upholding state law which provided tax exemption for bonds issued by the state, but not for those issues by other states).
24. *Granholm, supra*, 544 U.S. at 489.
25. If, as TransCanada has argued, Massachusetts' decision to award PPAs only to in-state resources is Constitutionally suspect, it's unclear why the numerous state PUC decisions over more than a century awarding to franchised utilities the exclusive right to build and rate-base new infrastructure projects isn't similarly suspect.