BLANK ROME LLP
COUNSELORS AT LAW

Phone: *(212) 885-5018*
Fax: *(917) 332-3063*
Email: *NGiannasca@BlankRome.com*

June 21, 2013

VIA ELECTRONIC FILING

Hon. Jeffrey C. Cohen
Acting Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, NY 12223-1350

Re: 03-E-0188 - Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard

Dear Secretary Cohen:

Attached for filing in the above-referenced proceeding is the Petition for Rehearing of HQ Energy Services (U.S.) Inc. Copies of the attached pleading are being served herewith on the active parties in the above proceeding.

Respectfully submitted,

/s/ Nicholas A. Giannasca
Nicholas A. Giannasca

NAG:mr
Attachment

cc: Active Parties (via e-mail or USPS First Class Mail w/attachment)

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard	**CASE 03-E-0188**

PETITION FOR REHEARING OF H.Q. ENERGY SERVICES (U.S.) INC.

Nicholas A. Giannasca
Elizabeth A. Stern
BLANK ROME LLP
Attorneys for H.Q. Energy Services (U.S.) Inc.
405 Lexington Avenue
New York, NY 10174
Phone (212) 885-5000
Ngiannasca@blankrome.com
Estern@blankrome.com

Dated: June 21, 2013

Table of Contents

Page

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard	CASE 03-E-0188

**PETITION FOR REHEARING
OF H.Q. ENERGY SERVICES (U.S.) INC.**

I. PRELIMINARY STATEMENT

Pursuant to Section 3.7 of the New York State Public Service Commission's ("Commission's") Rules and Regulations, H.Q. Energy Services (U.S.) Inc. ("HQUS"), the power marketing subsidiary of Hydro-Québec in the United States, hereby petitions for rehearing of the Commission's order issued May 22, 2013 in the above-captioned case (the "May Order").[1] In the May Order, the Commission, in response to the New York State Energy Research and Development Authority's ("NYSERDA's") petition, dated December 14, 2012,[2] revised the Renewable Portfolio Standard ("RPS") rules to exclude out-of-state projects from participating in NYSERDA's solicitation and procurement of Renewable Energy Certificates ("RECs") from Main Tier renewable energy projects.

Due to numerous procedural and substantive infirmities in the May Order, including numerous instances of arbitrary and capricious rulemaking, HQUS hereby requests that the Commission grant rehearing of the May Order by either: (a) nullifying the establishment of a prohibition against out-of-state participation in Main Tier solicitations; or (b) nullifying such prohibition for purposes of NYSERDA's current Main Tier solicitation (*i.e.*, the 8th Main Tier

---

[1] Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, *Order Modifying Renewable Portfolio Standard Program Eligibility Requirements* (issued May 22, 2013).
[2] Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, *NYSERDA Petition for Modification of Main Tier RPS Program* (filed Dec. 14, 2012) ("Petition").

Solicitation) and deferring to the 2013 RPS program re-evaluation[3] (and the related examination of relevant issues by interested stakeholders) the question of whether such a prohibition should be established as part of the RPS program.

II. BACKGROUND

The Commission adopted the RPS in 2004 with the goal of increasing the percentage of electricity consumed in New York that is generated by renewable resources. To achieve this goal, which is now 30% by 2015, the Commission authorized NYSERDA to procure RECs from renewable resources through Main Tier and Customer-Sited solicitations. With respect to the Main Tier solicitations, NYSERDA issues requests for proposals in the form of sealed, pay-as-bid auctions. In exchange for monetary payment, selected developers sell all rights and claims to the RECs associated with each megawatt-hour that the selected developer's facility produces. Bids submitted by developers are subject to NYSERDA's evaluation criteria, in which 70% of a developer's evaluation score is comprised of the bid price and the remaining 30% is comprised of the expected economic benefits to New York.

For almost a decade, the Commission has recognized the value of permitting out-of-state resources to participate in RPS Main Tier auctions. In September 2004, the Commission recognized that out-of-state projects could participate in the RPS program provided they complied with the Commission's in-state delivery requirement.[4] In fact, the Commission noted that such a requirement was "consistent with and in furtherance of [the Commission's] stated goals of increasing the amount of renewable energy retailed in the State, improving energy

---

[3] Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, *Order Establishing New RPS Goal and Resolving Main Tier Issues* at pp 26-27 (issued Jan. 8, 2010).

[4] *See* Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, *Order Regarding Retail Renewable Portfolio Standard* at p 61 (issued Sept. 24, 2004).

security, diversifying the State's electricity generation mix, reducing local air emissions and protecting against oil and natural gas price spikes or possible supply disruptions."[5]

In January 2006, the Commission declined to adopt rules favoring in-state projects, noting that adopting such rules "could be viewed as economic protectionism."[6] Furthermore, the Commission rejected suggestions to impose application hurdles on out-of-state projects in October 2006 because "[t]he RPS Program is stronger, more successful, and enjoys public support to the degree that it is administered objectively."[7] In that same order, the Commission also declined to increase the weight given to a proposed project for the expected economic benefits above 30% because that percentage allocation struck a "reasonable balance" between the economic benefits of a project and the bid price (which constitutes the other 70% of a project's score) when evaluating projects.[8] This evaluation percentage allocation was reconfirmed by the Commission in December 2010.[9]

The Commission has taken steps over the years (*e.g.*, in-state delivery requirement and hourly-matching requirement) to ensure that out-of-state resources can participate in the Main Tier auction process without raising the RPS program costs for ratepayers.[10] To date, three out-

---

[5] *Id.*

[6] Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, *Order Authorizing Additional Main Tier Solicitations and Directing Program Modifications* at pp 34-35 (issued Jan. 26, 2006).

[7] Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, *Order Authorizing Solicitation Methods and Consideration of Bid Evaluation Criteria and Denying Request for Clarification* at p 12 (issued Oct. 19, 2006).

[8] *Id.* at p 17.

[9] Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, *Order Authorizing Additional Main Tier Solicitation and Setting Future Solicitation Guidelines* at p 9 (issued Dec. 3, 2010).

[10] *See* Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, *Order on Delivery Requirements for Imports from Intermittent Generators* (issued June 28, 2006).

of-state projects have received Main Tier awards (despite the 30% allocation for economic benefits), and one of those is a foreign resource.[11]

In the Petition, NYSERDA requested that the Commission issue an order limiting the participation for Main Tier solicitations to in-state generators. NYSERDA asserted that such a limitation will promote three principal objectives of the RPS program: environmental improvement, energy security and economic benefits to New York.[12] Additionally, NYSERDA argued that the prohibition would not violate the "dormant" Commerce Clause of the United States Constitution because NYSERDA is acting as a participant in the REC market, thus falling within the "market-participant" exception to the Commerce Clause's prohibition on discriminatory state action.[13]

In the May Order, the Commission accepted NYSERDA's proposal to exclude bidders proposing to develop out-of-state renewable resources from participating in the Main Tier procurement process, but it declined to adopt the rationale proffered by NYSERDA. Rather, the Commission grounds its ruling on its unspecified "experience" with the RPS program and on the basis that two economic developments (falling gas prices and the termination of the production tax credit ("PTC")) will drive up the cost of the REC premium needed to induce entities to develop a project under the RPS program and, hence, it is more important to ensure that "all of the resulting benefits" from the RPS program are maximized to benefit New York ratepayers.[14]

---

[11] *See* NYSERDA, *The New York State Renewable Portfolio Standard Performance Report* (released April 1, 2013) ("NYSERDA Report") at pp A-1 and A-2.

[12] NYSERDA Petition at p 1.

[13] *Id.* at p 6.

[14] May Order at p 32. While NYSERDA's Reply Comments filed in this proceeding make reference to the PTC, those comments merely observe that the imminent expiration of the PTC warrants an expedited resolution by the Commission of NYSERDA's Petition. Case 03-E-0188, Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, *Reply Comments of NYSERDA* at p 11 (filed March 7, 2013) ("Reply Comments"). NYSERDA did not assert in its Petition or Reply Comments that the expiration of the PTC (coupled with anticipated and sustained low gas prices) will inevitably lead to higher Main Tier award amounts and, as a consequence, the need to maximize in-state benefits. Clearly, interested parties had no opportunity before the

Additionally, the Commission offered the argument that the geographic prohibition could escape scrutiny under the Commerce Clause because the Main Tier award functions as a "subsidy."[15]

III. SUMMARY OF POSITION

The Commission engaged in arbitrary and capricious rulemaking because it justified its establishment of a geographic prohibition on factors that were not addressed in the NYSERDA Petition or Reply Comments (or any other party's comments) and, therefore, were not subject to stakeholder commentary or the development of a full and complete record, namely: (a) changed economic circumstances, including low natural gas prices and an expiring PTC, that will allegedly drive up the Main Tier award premium for RECs; and (b) that the award of a Main Tier contract constitutes a subsidy that is outside the purview of constitutional challenge under the Commerce Clause of the United States Constitution. Furthermore, the Commission justifies its decision based on its "experience" with the RPS program, which is totally unsupported by the Commission's own analysis.

Even assuming the Commission's justifications for its May Order were properly considered and were made based on a fully developed record, the Commission commits numerous errors of fact and law in its May Order. First, the Commission's primary rationale for the policy change is that the "evolution of economic circumstances," including the long-term impact of lower natural gas prices on the development of renewable projects and the termination of the PTC at the end of 2013, will collectively lead to higher RPS program costs and, hence, requires that the Commission ensure that in-state benefits are maximized. The Commission's analysis regarding the impact of these changed circumstances is speculative, unsupported, unjustified and erroneous factually.

---

issuance of the May Order to challenge the Commission's "changed economic circumstances" foundation for a major change in the RPS program.

[15] May Order at p 34.

Additionally, the Commission made several unsupported and unjustified statements, including its baseless (and irrelevant) assertion that NYSERDA has shown that economic benefits provided by in-state projects are "substantial" in relation to the cost of the RPS program premiums necessary to induce the participation of developers. Furthermore, the Commission provides no support for its statement that out-of-state projects "do not maximize all resulting benefits" including economic, energy security and environmental benefits.

Lastly, the Commission committed an error of law in concluding that the award of a Main Tier contract is a subsidy and, thus, outside the purview of the "dormant" Commerce Clause of the United States Constitution. Because developers are required to provide consideration to NYSERDA, namely, the environmental attributes associated with each megawatt-hour of electricity generated by the applicable project (instead of selling such attributes on the open market), in exchange for monetary compensation, the award of a Main Tier contract is not properly construed as a subsidy. Even if the award of a Main Tier contract is deemed to be a subsidy, it is far from a settled question that discriminatory subsidies are clear of constitutional challenge. At its core, the prohibition against out-of-state participation represents a facially discriminatory and protectionist feature of the RPS program that (a) cannot withstand the heightened level of scrutiny that must be applied to evaluate this prohibition for purposes of the U.S. Constitution's Commerce Clause, and (b) cannot be excused through reliance on the "market-participant" exception or the characterization of the Main Tier award as a subsidy.

Because the May Order represents arbitrary and capricious rulemaking and is replete with egregious errors of fact and law, the geographic prohibition established in the May Order should be reversed completely or, at a minimum, nullified for the purposes of application to

NYSERDA's current Main Tier solicitation and deferred to a more comprehensive and fulsome review as part of the Commission's upcoming 2013 review of the RPS program.

IV. ARGUMENT

A. The Commission Engaged In Arbitrary And Capricious Rulemaking By Relying On Factors That Were Not Subject To Stakeholder Commentary And For Which There Was No Record Developed

The Commission rests the establishment of an out-of-state prohibition on several grounds that were not addressed in the NYSERDA Petition or its Reply Comments[16] and, as a result, stakeholders were never granted an opportunity to comment on such justifications and no record was developed on these matters. Such justifications include: (a) changed economic circumstances, including low natural gas prices and an expiring PTC, that will purportedly increase the premium price of RECs and the associated cost of administering the RPS program; and (b) the characterization of the award of a Main Tier contract as a subsidy that is outside the purview of a constitutional challenge under the Commerce Clause. While it is permissible for the Commission to modify the RPS program, any such alteration (particularly a reversal of well-settled policy that has been consistently developed and re-examined over the past decade) should be based on reasoned decision-making on an adequate record and not an arbitrary "after-the-fact" rationalization.[17]

The Commission compounds its arbitrary and capricious rulemaking by relying on a statement that it never even attempts to support. Specifically, the Commission states that its

[16] Even if these factors were addressed in the NYSERDA's Reply Comments, which they were not, the Commission failed to grant interested parties the opportunity after the filing of the Reply Comments for additional submissions to address their concerns and to create a more complete record for the Commission's consideration.

[17] *See Matter of Pell v. Bd. of Educ.*, 34 N.Y.2d 221, 231 (1974) (noting that in reviewing an agency decision, a court can apply the arbitrary and capricious test, which chiefly "relates to whether a particular action should have been taken or is justified … and whether the administration action is without foundation in fact, and noting that arbitrary agency action is without sound basis in reason and is generally without regard to the facts) (citation omitted).

"experience" with the RPS program justifies its change of policy.[18] Although the Commission points to its amorphous "experience" as one of only two broad justifications for changing an important policy, the May Order is completely bereft of any explanation linking the Commission's RPS "experience" and the need to create a program restriction that is clearly a protectionist impediment to the interstate flow of electricity and associated RECs.

B. <u>The Commission Committed Errors Of Fact In Basing Its Change In RPS Policy On The "Evolution Of Economic Circumstances"</u>

After a period of several years and numerous Main Tier auctions, during which the Commission endorsed the participation of out-of-state resources in the Main Tier procurement process, the Commission relied on newly-recognized circumstances, which it claims have developed since 2010, to support a drastic modification of the RPS program. Even assuming stakeholders had an opportunity to comment on the Commission's recently recognized rationale for this change in policy, the Commission's presentation and analysis of changed economic circumstances are fraught with errors of fact and do not amount to reasoned deliberation.

The Commission claims that there have been two important developments in the period of 2010 to the present that fundamentally affect the economics of the RPS program.[19] The first development, described largely without citation to data or other support in the record, is that the price of gas has dropped significantly and on a sustained basis, thereby causing prices for electricity as "projected" to remain low relative to historical prices.[20] The second changed circumstance cited is the current uncertainty regarding the continued availability of the PTC beyond 2013. The Commission contends that together, these developments "are likely to

[18] May Order at p 22.
[19] *Id.* at p 28.
[20] *Id.* at p 29.

increase the cost of the premium necessary to induce a developer to undertake an RPS project"[21] and somehow require in-state benefits to be maximized.

The Commission ignores the fact that many factors impact the price of building renewable energy projects and, instead, focuses solely on two potential factors (*i.e.*, sustained lower natural gas prices and the expiration of the PTC). Other critical factors include the maturity of technology, the availability of transmission capacity and the overall economy (which in turn impacts other indirect costs such as labor and materials). The Commission cannot focus solely on two factors, which are unsupported and unjustified, to conclude that the cost of developing new renewable facilities will increase (and, as a result, supposedly, drive up the REC premium required to induce developers to participate in the RPS program).

1. <u>The Commission Findings On The Impact Of Low Natural Gas Prices On The RPS Program Are Speculative, Unsupported And Unjustified</u>

The Commission provides no basis for the claim that gas prices will remain low on a "sustained basis" which will lead to continued lower electricity prices.[22] This is speculation, not reasoned rulemaking. Various factors can place upward pressure on gas prices, including natural gas exportation, moratoria and restrictions on natural gas extraction, and a rebounding national economy. Furthermore, forecasts of future natural gas prices from reputable sources indicate that, far from anticipated low natural gas prices, the price of natural gas will rise steadily. For example, the U.S. Energy Information Administration ("USEIA") has indicated (as the chart

---

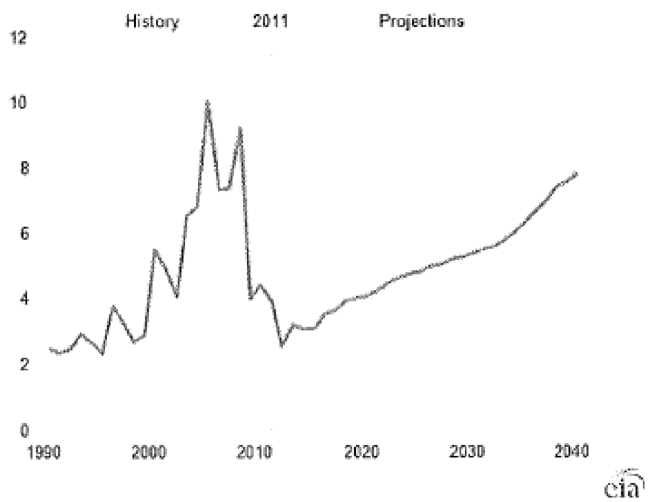
[21] *Id.*

[22] *Id.* With lower electricity prices, the Commission asserts, the cost of the RPS award must increase in order for a RPS developer to receive the same revenues as when electricity prices are higher. *See id.* at p 31. The Commission offers no justification or analysis to support its underlying assumption, namely, that developers will bid in a fashion that looks to replace lower electricity revenue "dollar for dollar" with higher REC revenue. Numerous factors (*e.g.*, the cost of financing) will influence the amount bid, and it is possible for a developer to absorb a portion of the projected, lower electricity revenue, for example, by adjusting its required rate of return.

below reflects) that natural gas prices are anticipated to rise steadily to 2040:

Natural gas prices rise with an expected increase in production costs after 2015

Figure 86. Annual average Henry Hub spot natural gas prices, 1990-2040 (2011 dollars per million Btu)



According to the USEIA, "U.S. natural gas prices have remained relatively low over the past several years as a result of abundant domestic supply and efficient methods of production. However, the cost of developing new incremental production needed to support continued growth in natural gas consumption and exports rises gradually ". . . [will lead] to an increase in the Henry Hub spot price. Henry Hub spot prices for natural gas [will increase] by an average of about 2.4 percent per year, to $7.83 per million Btu (2011 dollars) in 2040 (Figure 86)."[23]

Moreover, under the Commission's reasoning, it should have instituted a prohibition on out-of-state projects in order to maximize in-state benefits in 2010 because, at that time, natural gas prices had plummeted over the prior two years (2008-2010)[24] and, the megawatt-hour weighted average award price has increased from $14.75 in the November 2007 solicitation to

[23] *See USEIA Energy Annual Outlook*, Report Number DOE/EIA-0383 (issued April 15, 2013).
[24] *See* May Order at p 30.

$21.17 in the March 2010 solicitation.[25] Yet the Commission reaffirmed the right of out-of-state projects to participate in the RPS program.[26]

An additional flaw in the Commission's reasoning is its failure to recognize that a fall in natural gas prices, if sustained, will have an equivalent impact on both in-state and out-of-state projects. Assuming that the Commission is correct, falling wholesale prices for electricity resulting from natural gas prices will constitute a market signal to all potential developers that a primary source of project revenue will be impaired. Since the supposed impact of lower electricity prices is "across the board," there is no justification to prohibit out-of-state developers from participation. All developers will likely seek to recoup lost electricity revenue in their bids in some fashion. Hence, out-of-state developers should still be permitted to participate in NYSERDA's RPS solicitations for the prospect that (despite the revenue impact of falling gas prices) other aspects of their projects can provide commensurate and comparatively superior benefits.

2. <u>The Commission Engages in Speculation and Commits Numerous Errors Of Fact Regarding The PTC</u>

As with the forecast for a period of sustained lower natural gas prices, the Commission's pronouncements regarding the termination of the PTC are equally speculative. The termination of the PTC is far from certain. Numerous and influential entities will assuredly pressure Congressional representatives for an extension beyond 2013. As Congress has demonstrated, the termination of the PTC is never assured until it is terminated. Even if the PTC terminates at the end of 2013, it is not correct factually to conclude that developers will require additional REC

---

[25] *See* NYSERDA Report at p 18.

[26] The Commission previously noted that one benefit of stimulating renewable energy development is the protection that such resources would provide against "spikes" in natural gas prices. *Order Regarding Retail Renewable Portfolio Standard*, *supra* note 4 at p 61. Inexplicably, the Commission, in its May Order, relies on the opposite scenario – the anticipation of sustained, low natural gas prices – to limit participation in a program intended to diversify the resource mix to afford New York ratepayers such protection against natural gas price spikes.

revenue to replace this financial incentive. As the Commission recognized, developers eligible for the PTC are often eligible to take, and often avail themselves of, other incentives (*e.g.*, the Investment Tax Credit).[27]

The uniform impact of the PTC's expiration also escapes the Commission's analysis. If the PTC is terminated at the end of 2013, both in-state and out-of-state developers (in the United States) will be equally impacted and, hence, should be permitted to bid to determine if other aspects of their bids can provide superior benefits despite the potential revenue impact of losing the PTC. Even if the demise of the PTC will lead inexorably to higher REC award prices, there is no reason to prevent any bidder from participating because the more bidders that participate, the better the chances are that the rise in Main Tier award prices will be tempered.

As between in-state developers and neighboring foreign developers, (*i.e.*, developers of projects located outside of the U.S.) the termination of the PTC means an end to a decided advantage for the in-state developer. The PTC is not available to developers of projects that generate electricity outside of the United States. If the foreign developer, who is able to satisfy all delivery requirements of the RPS program, can bid a lower price than an in-state developer that is deprived of the PTC, and have a superior bid despite the 30% allocation for in-state economic benefits, then that foreign bidder should prevail for the benefit of New York's ratepayers. There is nothing in the elimination of the PTC that warrants the exclusion of out-of-state developers in the United States (who are equally impacted) or foreign developers (who may be able to provide more competitive bids due to the creation of a more level playing field).[28]

[27] May Order at pp 30-31 fn 29.

[28] An issue related to the impact of the May Order on foreign developers, which is entirely ignored by the Commission (and NYSERDA), is that the RPS prohibition may be violative of trade pacts and agreements to which Canada and the United States are parties, including the North American Free Trade Agreement. As noted above, a developer of a foreign project (a hydroelectric facility in Québec) has secured a Main Tier award, but that same developer would be completely precluded from participating in the RPS Main Tier solicitations as currently structured.

It is noteworthy that, despite its recognition that the cost of RPS awards is likely to rise in light of so-called sustained lower gas prices and the expiration of the PTC, the Commission took no action with regard to the evaluation criteria applicable to in-state developers (*i.e.*, the 30% evaluation allocation to economic benefits) to ensure that in-state benefits are maximized in a program available only to in-state developers. If the Commission is truly concerned with rising RPS costs and enhancing in-state benefits, then presumably it would have increased the 30% evaluation criterion, but it did not. The absence of such action may reveal the true intent behind the endorsement of a geographic prohibition – economic protectionism.

C. The Commission Engaged in Faulty Reasoning and Committed Additional Errors of Fact in the May Order

Several additional errors of fact in the May Order simply underscore that the Commission has not engaged in reasoned rulemaking. There is no basis for the claim, nor does the Commission try to provide one, that NYSERDA has shown that the economic benefits provided by in-state projects are "substantial" in relation to the cost of the RPS premiums needed to induce the projects.[29]

Even if the Commission's claim is correct, the relationship between economic benefits provided by in-state projects and the cost of RPS premiums is not germane to the question of whether the Commission should exclude out-of-state projects from participating in the Main Tier solicitations. NYSERDA's evaluation process already considers economic benefits (and in-state developers are positioned to benefit from this criterion), as part of assessing the overall attractiveness of a developer's bid. If an out-of-state developer cannot bid a project with composite benefits (*e.g.*, price and positive economic impacts) superior to in-state projects, that developer's bid will not be selected. Therefore, the question is not whether in-state projects

[29] *See* May Order at p 32.

provide "substantial" benefits in relation to RPS premiums, but rather whether out-of-state projects should be prohibited from showing that they can develop superior projects, with substantial benefits, considering all factors (*e.g.*, price and in-state benefits).

Furthermore, there is no basis in the record for the Commission's claim that out-of-state projects "do not <u>maximize</u> all of the resulting benefits – in terms of economics as well as energy security and environmental benefits."[30] No evidence or support is offered by the Commission for this sweeping statement. Moreover, the Commission ignores the purpose of the evaluation process, which is to determine what bidding resources maximize (as compared to all bids offered) the core benefits of economics, energy security and environmental benefits.[31]

The Commission notes that the elimination of bids from out-of-state projects will not likely significantly affect the price of awarded Main Tier contracts or the ability of the State to meet the Commission's RPS goal at a reasonable cost.[32] Implicitly, the Commission is conceding, as it has recognized in prior orders, that bids from out-of-state developers will enhance the prospect of lower bid award levels and overall lower RPS costs. Hence, it is non-sensical for the Commission to eliminate the price suppressing benefit of additional (out-of-state) bids all for the alleged objective of maximizing in-state benefits (which are already captured in the 30% criterion).

---

[30] *See id.* (emphasis added).

[31] As the Commission has recognized, the diversity of renewable resources (which will be hampered by the Commission's action in the May Order) enhances energy security. *See Order Regarding Retail Renewable Portfolio Standard*, *supra* note 4 at p 61. As well, the Commission has noted that the delivery of renewable energy into New York will provide environmental benefits from the displacement of dirtier, in-state sources of electricity. *See id.* Moreover, the NYSERDA Report, in contrast to the Commission's statement, indicates that the "new renewable generation capacity from facilities awarded contracts under the seven completed Main Tier competitive solicitations [which includes 3 out-of-state projects] and future solicitations <u>will provide environmental benefits</u> to the State of New York." NYSERDA Report at 19 (emphasis added).

[32] May Order at p 32.

The participation of out-of-state projects will not, as the Commission contends, lead to foregoing the "higher level of benefits provided by an in-State project."[33] NYSERDA's scoring mechanism, which allocates 70% of the score to the bid price and the remaining 30% to the economic benefits of the project, recognizes the economic benefits of in-state projects, while also providing an opportunity for an out-of-state project to win an award if its bid price is sufficiently low to outweigh the competitively higher in-state benefits a competing in-state developer may provide.

Finally, the Commission draws no link between prohibiting out-of-state developers from participation and attaining its "long-standing goal of structuring the RPS program to maximize the benefits that accrue to New York and to serve important State interests, including supply security, supply diversity, and economic and environmental well-being."[34] Without such linkage, the Commission engages in arbitrary and capricious rulemaking by implying that it needs to prohibit out-of-state developers from participation in the RPS program in order to serve these important interests.

D. <u>The Commission Committed An Error Of Law By Concluding That Its Change in RPS Policy Does Not Violate the Commerce Clause of The United States Constitution</u>

Article I, Section 8 of the Constitution of the United States, commonly called the Commerce Clause, gives Congress the power to "regulate Commerce with foreign Nations, and among the several States, and with the Indian tribes." The United States Supreme Court

[33] May Order at p 33.

[34] *Id.* As the Commission has recognized, supply security, supply diversity and environmental well-being will all be served by a RPS program with robust participation (including out-of-state developers) and an in-state delivery requirement. *See Order Regarding Retail Renewable Portfolio Standard*, *supra* note 4 at p 61. The "economic" State interest is accomplished through NYSERDA's evaluation process, which appropriately recognizes and evaluates bids that demonstrate in-state economic benefits.

("Court") has read into this a "dormant" Commerce Clause that precludes individual states from acting in a way that discriminates against other states in interstate commerce.[35]

When an issue related to the regulation of commerce between the states escapes the attention of Congress, individual states may regulate as long as they act in accordance with the Commerce Clause.[36] The basic purpose of the "dormant" Commerce Clause is to make the country one economic unit and avoid state by state economic isolationism and protectionism.[37] State laws passed for the purpose of economic protectionism are deemed facially discriminatory and are subject to strict scrutiny.[38] If a court finds that a law is discriminatory, it next looks to whether there is a compelling government interest in that discrimination and whether the same interest can be accomplished in a nondiscriminatory way.[39] Discriminatory state laws that advance a legitimate and compelling government purpose that cannot be accomplished through a nondiscriminatory alternative may still survive, but this is rare at the strict scrutiny level.[40]

In a recent, noteworthy case, the United States Court of Appeals for the Seventh Circuit had the opportunity to comment on an RPS program, that, like New York's current RPS program, facially discriminates against out-of-state sources of renewable power.[41] Michigan argued that, because utilities in the state could not use purchases of renewable power from out-of-state resources to satisfy Michigan's RPS requirements, its ratepayers should not be required to share the cost of developing high-voltage transmission facilities across twelve states in the

---

[35] *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 192 (1994**).**
[36] *City of Philadelphia v. NJ*, 437 U.S. 617, 623 (1978).
[37] *See id.*
[38] *Id.* at 624.
[39] *New Energy Co. v. Limbach*, 486 U.S. 269, 278 (1988).
[40] *See id.* The geographic prohibition established by the Commission advances no legitimate state purpose. Even if one concedes that the RPS program needs to be modified to maximize in-state benefits, the Commission could have addressed this objective in a less discriminatory manner by, for example, according a higher evaluation criterion percentage to "economic benefits," particularly since such a modification to the RPS program would have potentially avoided the constitutional infirmities related to the geographic prohibition.
[41] *Ill. Commerce Comm'n., et al., v. Fed. Energy Regulatory Comm'n.*, 2013 U.S. App. LEXIS 11560 (7d Cir. 2013).

Midwest that would serve to transmit out-of-state renewable power. The court noted that "Michigan cannot, without violating the commerce clause of Article I of the Constitution, discriminate against out-of-state renewable energy."[42] This case, while not ruling on the constitutionality of Michigan's RPS program, highlights the enhanced scrutiny that courts will apply to discriminatory features of RPS programs and counsels states to avoid structuring their RPS programs in such ways (*e.g.*, geographic prohibitions) that violate the Commerce Clause.

Adopting an analytical approach in direct conflict to that presented by NYSERDA in the Petition, the Commission concluded that the prohibition on the participation of out-of-state projects in RPS program <u>does not</u> violate the "dormant" Commerce Clause because it found an RPS contract award to be a subsidy, which, according to the Commission, is "outside the purview of the "dormant" Commerce Clause."[43] Essentially the Commission asserts that the RPS contract award is a subsidy because it is an "incentive payment" and the mechanism in which the subsidy amount is determined (*i.e.*, the auction process) does not deem the REC to be "an article of interstate commerce."[44]

NYSERDA, on the other hand, argued that it acts as a "market-participant" – that is, NYSERDA is a direct participant in the market and does not regulate the market (*i.e.*, interstate commerce). States may avoid violations of the dormant Commerce Clause when they are deemed market-participants, thereby allowing them to favor in-state business.[45] Because it claims to be a "market-participant," NYSERDA asserts that the prohibition is exempt from scrutiny under the Commerce Clause.[46]

---

[42] *Id.* at *15 (citations omitted).
[43] May Order at p 34.
[44] *Id.*
[45] *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810 (1976). The rationale for the "market-participant" exception is that when states act as market-participants, rather than market regulators, they are free to do business in the free market, just as private businesses would. *Reeves, Inc. v. Stake*, 447 U.S. 429, 436–37 (1980).
[46] *See* NYSERDA Petition at 6.

Even if one assumes that RECs are part of a market, such an argument does not logically lead to the conclusion that NYSERDA is a market-participant that falls under the exception. In *United Haulers Assoc. Inc. v. Oneida-Herkimer Solid Waste Management Authority*, the Court found New York qualified as a "market-participant" because New York chose to give preferential treatment to a waste facility funded by the state, while treating all private facilities equally.[47] Here, preference is not being given to a government-owned or -funded renewable energy developer, while discriminating against <u>all</u> private renewable energy developers. Instead, New York is <u>only</u> discriminating against private renewable energy developers located outside of New York. Thus, NYSERDA is not acting as a market-participant as recognized by the United States Supreme Court and the market-participant exception should not apply to protect the geographic prohibition from being invalidated by the Commerce Clause.

The Commission, in its May Order, asserts that no market exists because "NYSERDA is the one and only buyer" and dismisses the NYSERDA's "market-participant" argument in favor of its own subsidy argument (for which stakeholders had no opportunity to comment on and no record was developed). The award of a Main Tier contract, however, cannot be considered a subsidy because it entails more than a government entity providing a financial payment to a private entity in an effort to induce that private entity to undertake a certain action. When a developer is awarded a Main Tier contract, it does receive a certain amount of money from NYSERDA for the RECs associated with the megawatt-hour of electricity generated by the developer's facility (albeit the amount received is determined through the auction), but, in return, the developer is contractually required to transfer all rights to such RECs to NYSERDA. Because the developer could sell these attributes on an open market, the developer is providing real, valuable consideration to NYSERDA in exchange for a monetary payment. NYSERDA,

[47] 550 U.S. 330 (2007).

therefore, is not providing a subsidy to winning developers – it is actually purchasing a marketable commodity in a contractual exchange with developers.

Even if the Commission's conclusion is correct that a Main Tier award amounts to a subsidy, the Court has not definitively adopted the position that discriminatory subsidies are allowed under the Commerce Clause. More recent Court cases specifically suggest that subsidies are an open issue.[48] In *W. Lynn Creamery*, the Court explicitly notes that it has never squarely confronted the constitutionality of "subsidies" and did not do so then. Justice Scalia, dissenting in *W. Lynn Creamery*, argued that, "subsidies for in-state industry… would clearly be invalid under any formulation of the Court's guiding principle" for "dormant" Commerce Clause cases.[49] In *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, which was cited by the Commission for the proposition that the Court has suggested subsidies are outside "the purview of the "dormant" Commerce Clause," the Court cites *W. Lynn Creamery* in acknowledging that it has never formally ruled on the subject.[50] This is hardly the type of judicial precedent that the Commission may rely on to support its "subsidy" argument and a resulting significant change in its RPS policy.

In light of the fact that Main Tier contracts are not awarded as traditional subsidies (because of the mutual consideration), NYSERDA's solicitation process (*i.e.*, the auction and the evaluation allocation between price and economic benefits) and the Court's increasingly open stance on the constitutionality of discriminatory subsidies, the Commission does not provide a sufficient basis (and errs as a matter of law) in concluding that the prohibition on external

[48] *See W. Lynn Creamery, Inc.*, 512 U.S. at 197, n. 15 (1994**)**.
[49] *See id.* at 208 (Scalia, J., concurring).
[50] 20 U.S. 564, 589 (1997). Older cases do suggest a stronger view that subsidies fall outside the "dormant" Commerce Clause, but they are less persuasive in light of later cases, such as *Camps Newfound/Owatonna, Inc. v. Town of Harrison*.

resources in the Main Tier program would in fact be found by the Court to be constitutional under its "subsidy" line of cases.

V. CONCLUSION

For the reasons set forth herein, the Commission should grant rehearing of the May Order by either: (a) nullifying the establishment of a prohibition against out-of-state participation in Main Tier solicitations; or (b) nullifying such prohibition for purposes of NYSERDA's current Main Tier solicitation (*i.e.*, the 8th Main Tier Solicitation) and deferring to the 2013 RPS program re-evaluation (and the related examination of relevant issues by interested stakeholders) the question of whether such a prohibition should be established as part of the RPS program.

Respectfully submitted,

<u>/s/ Nicholas A. Giannasca</u>

Nicholas A. Giannasca
Elizabeth A. Stern
BLANK ROME LLP
405 Lexington Avenue
New York, NY 10174
Phone (212) 885-5000
Ngiannasca@blankrome.com
Estern@blankrome.com

Counsel for H.Q. Energy Services (U.S.) Inc.

Dated: June 21, 2013
New York, New York