UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

LSP Transmission Holdings, LLC,

Plaintiff,

vs.

Nancy Lange, Commissioner and Chair, Minnesota Public Utilities Commission, Dan Lipschultz, Commissioner, Minnesota Public Utilities Commission, Matt Schuerger, Commissioner, Minnesota Public Utilities Commission, John Tuma, Commissioner, Minnesota Public Utilities Commission, Katie Sieben, Commissioner, Minnesota Public Utilities Commission, and Mike Rothman, Commissioner, Minnesota Department of Commerce, each in his or her official capacity,

Defendants.

Case No. 17-cv-04490 DWF/HB

DEFENDANTS' MEMORANDUM IN SUPPORT OF MOTION TO DISMISS

INTRODUCTION

This memorandum is submitted on behalf of Defendants, in their official capacities as Commissioners of the Minnesota Public Utilities Commission (PUC) and Department of Commerce. This matter is a dormant Commerce Clause challenge to a Minnesota law granting electric utilities a right of first refusal to build and own electric transmission lines that connect to their existing facilities, Minn. Stat. § 216B.246. Plaintiff LSP Transmission Holdings (LSP) alleges the law discriminates against out-of-state transmission developers in favor of in-state electric utilities. The lawsuit fails

because, under *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997), the transmission developers and the heavily-regulated electric utilities are not similarly situated.

STATEMENT OF FACTS

A. Federal, Regional, And State Electric Regulation: FERC, PUC, And MISO.

The Federal Energy Regulatory Commission (FERC) has jurisdiction over the interstate transmission of electric energy and its sale at wholesale. 16 U.S.C. § 824(b)(1). The states retain jurisdiction over the retail sale of electric energy, as well as the "local distribution" and "transmission of electric energy in intrastate commerce." *Id.*

In Minnesota, electric service is provided by monopolies. Electric utilities are assigned to service areas:

> in order to encourage the development of coordinated statewide electric service at retail, to eliminate or avoid unnecessary duplication of electric utility facilities, and to promote economical, efficient, and adequate electric service to the public.

Minn. Stat. § 216B.37. Within their respective service territories, each electric utility has "the exclusive right to provide electric service at retail to each and every present and future customer in its assigned area and no [other] electric utility shall render or extend service at retail." Minn. Stat. § 216B.40. The PUC sets "just and reasonable" retail rates for public utilities, ensuring each provides "safe, adequate, efficient, and reasonable service," and "make[s] adequate infrastructure investments." Minn. Stat. §§ 216B.03–.04, and .79.

Regionally, FERC-approved nongovernmental entities known as independent system operators (ISOs) oversee the operation and expansion of transmission grids.

Compl. ¶ 14. Each ISO issues a tariff, which establishes the terms by which its members build and operate the grids. Compl. ¶ 15. ISO tariffs are subject to FERC approval. *Id.* Minnesota's electric utilities are covered by the Midcontinent Independent System Operator (MISO), which was created in 1998 and approved by FERC in 2001. Compl. ¶ 16.

B. FERC Eliminates Federal ROFR Provisions.

Until 2011, if MISO approved construction of a new transmission line, the MISO member that distributed electricity in the area where the facility would be built had a right of first refusal (ROFR) that gave it the "first crack" to build the line. Compl. ¶ 17; *MISO Transmission Owners v. FERC*, 819 F.3d 329, 332 (7th Cir. 2016). The ROFR existed pursuant to the terms of the organizing MISO members' transmission agreement and MISO's tariff. Compl. ¶ 17. Such ROFRs were common among ISOs. *Id.*

In 2011, FERC eliminated the federal ROFRs. Specifically, FERC Order No. 1000 required the elimination of provisions "in Commission-jurisdictional tariffs and agreements that establish a federal right of first refusal for an incumbent transmission provider with respect to transmission facilities selected in a regional transmission plan for purposes of cost allocation." 136 FERC ¶ 61,051 at P. 248. FERC supported this decision by citing "the benefits of competition in transmission development, and associated potential savings." *Id.* at P. 226.

Commissioner Philip Moeller filed a partial dissent to FERC Order No. 1000, in which he cited concerns about regional cooperation and reliability. 76 Fed. Reg. 49842, 49972 (Moeller, Comm'r, dissenting). He worried that transmission owners would focus

on projects where they may still retain ROFRs, such as wholly local projects, to the detriment of regional projects: "For this reason, instead of encouraging more regional cooperation, the rule could ultimately discourage such cooperation by encouraging more local transmission projects." *Id.* at 76 Fed. Reg. 49973.

Commissioner Moeller also expressed concern that the order limited a utility's ability to "maintain the reliability of its existing network." *Id.* It is a utility's obligation to serve the customers in its service area. But if a competitor is the one building new transmission lines to improve reliability in that service area, the utility loses "its authority to address reliability issues in its franchised service territory." *Id.*

C. Minnesota Enacts A State ROFR For Incumbent Transmission Development.

FERC Order No. 1000 terminated only federal ROFRs; it did not "limit, preempt, or otherwise affect state or local laws or regulations with respect to construction of transmission facilities." 136 FERC ¶ 61,051 at P. 227. In response to the order, several states, including Minnesota, enacted ROFR laws. *See, e.g.,* N.D. Cent. Code §49–03–02.2; S.D. Codified Laws §49–32–20; Neb. Rev. Stat. § 70-1028; 17 O.K. Stat. § 292.

Minnesota's ROFR law provides: "An incumbent electric transmission owner has the right to construct, own, and maintain an electric transmission line that has been approved for construction in a federally registered planning authority transmission plan and connects to facilities owned by that incumbent electric transmission owner." Minn. Stat. § 216B.246, subd. 2.

A primary purpose of the law was to preserve the status quo and avoid the uncertain effects of an unknown process for electric transmission development in

Minnesota. *See* Compl. ¶ 53 (citing legislative committee testimony that the bill was intended to "preserve the status quo"). At the Senate committee hearing on the ROFR bill, Senator David Brown, one of the bill's authors, stated: "Our regulated system has served Minnesota well, and our system is reliable and our rates are fairly competitive." *Hearing Before the Comm. on Energy, Utilities and Telecommunications*, S.F. 1815, 87th Minn. Leg. (2012) (Statement of Senator David Brown at 00:01:32).[1] However, he warned:

> If we choose not to pass this legislation, we are moving into the world of unknown, versus we have a very known process right now, members. And I think it's best to stick with that process because FERC's process is unknown.

Id. (Statement of Senator David Brown at 00:49:46). The bill passed and was signed into law in 2012. Compl. ¶ 56.

D. FERC Allows MISO To Assign Projects Based On Minnesota's ROFR Law.

MISO removed the federal ROFR provisions from its tariff, in accordance with FERC Order No. 1000. Compl. ¶ 45. At the same time, MISO added language establishing that transmission projects will be assigned in accordance with state ROFR

[1] The audio for this committee hearing is publicly available through the Minnesota Senate Audio Services, http://www.senate.mn/media/index.php?ls=&type=audio. A transcript of the committee hearing was also made by the Attorney General's Office and is submitted for the Court's convenience. *See* Affidavit of Julie Peick, Exhibit A. This legislative history is a public record and thus may be considered on a motion to dismiss. *See Shiraz Hookah, LLC v. City of Minneapolis*, No. 11-CV-2044, 2011 WL 6950483 at *2 (D. Minn. Dec. 30, 2011) (citing *Stahl v. U.S. Dep't of Agric.*, 327 F.3d 697, 700 (8th Cir. 2003)).

laws. *Id.* Thus, under the terms of the tariff, a new MISO-approved transmission project in Minnesota would be subject to Minnesota's ROFR law.

FERC approved MISO's decision to abide by state ROFR laws, recognizing that, "even if a transmission project is subject to a state right of first refusal, the regional transmission planning process still results in the selection for planning and cost allocation purposes of transmission projects that are more efficient or cost-effective than would have been developed but for such processes." 150 FERC ¶ 61,037 at P. 18; Compl. ¶ 46.

LSP petitioned for judicial review, "complain[ing] about FERC's having decided to allow MISO to include in its tariff a provision that allows it to honor rights of first refusal created by state and local law." *MISO Transmission Owners*, 819 F.3d at 336. The Seventh Circuit Court of Appeals held that FERC's desire "to avoid intrusion on the traditional role of the States in regulating the siting and construction of transmission facilities . . . was a proper goal" and dismissed LSP's challenge. *Id.* (internal quotation omitted).

E. LSP Files This Dormant Commerce Clause Lawsuit.

After arguments against state ROFR laws failed before FERC and the Seventh Circuit, LSP filed this lawsuit, claiming that Minnesota's ROFR law violates the dormant Commerce Clause. LSP alleges that the law discriminates against interstate commerce because it gives "incumbent utilities with an existing footprint in Minnesota the exclusive right of first refusal to build transmission lines," thus providing a barrier to interstate competition and blocking LSP's entry into the marketplace. Compl. ¶¶ 85–86, 95.

Defendants have moved to dismiss for failure to state a claim.

STANDARD OF REVIEW

When ruling on a motion to dismiss, a court must accept the facts alleged in the complaint as true and grant all reasonable inferences in the plaintiff's favor. *Crooks v. Lynch*, 557 F.3d 846, 848 (8th Cir. 2009). To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to "state a claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007).

ARGUMENT

The Commerce Clause establishes Congress's power over interstate commerce. U.S. Const., Art. I, § 8, cl. 3. The dormant Commerce Clause is the negative implication of the Commerce Clause and establishes that states may not enact laws that discriminate against or unduly burden interstate commerce. *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992). State laws violate the dormant Commerce Clause if they mandate "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Granholm v. Heald*, 544 U.S. 460, 472 (2005). This mandate "reflect[s] a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Id.*

A state law that is challenged on dormant Commerce Clause grounds is subject to a two-tiered analysis. First, the court considers whether the law in question patently or overtly discriminates against interstate commerce. *R & M Oil & Supply, Inc. v.*

Saunders, 307 F.3d 731, 734 (8th Cir. 2002). A statute patently or overtly discriminates if it is discriminatory on its face, in its purpose, or through its effects. *Id.* If the law is patently or overtly discriminatory, it is per se unconstitutional, unless the state can demonstrate, "under rigorous scrutiny, that it has no other means to advance a legitimate local interest." *C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 392 (1994). If the law is not patently or overtly discriminatory, the second analytical tier provides that the law will be struck down only if the burden it imposes on interstate commerce "is clearly excessive in relation to its putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

Under either tier, LSP's claim is foreclosed by *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997).

A. *Tracy* Forecloses LSP's Claim Of Patent Discrimination.

In *General Motors Corp. v. Tracy*, the Supreme Court held that private businesses and energy utilities with local monopolies are not similarly situated for purposes of a claim of patent discrimination under the dormant Commerce Clause, and thus arguments that a state law discriminates between private businesses and local energy utilities must fail. *Tracy*, 519 U.S. at 310. The Court's rationale was to avoid judicial intervention that might possibly hinder the distribution of energy to consumers in a monopoly market. *Id.* at 304. This holding and rationale apply to this matter and foreclose LSP's claim of patent discrimination.

Tracy involved a dormant Commerce Clause challenge to an Ohio law that exempted state-regulated natural gas utilities from sales and use taxes. *Tracy*, 519 U.S. at

281–83. General Motors, which had purchased natural gas from out-of-state marketers whose sales were subject to the taxes, objected that the exemption for the local utilities patently discriminated against interstate commerce. *Id.* at 297–98. The Supreme Court rejected this claim in several analytical steps, each of which applies to this case.

The *Tracy* Court began its analysis with a threshold question that applies to all dormant Commerce Clause cases: whether the in-state and out-of-state entities are "substantially similar"—that is, whether they compete in the same market. *Id.* at 298–99. If they do not, then "eliminating the tax or other regulatory differential would not serve the dormant Commerce Clause's fundamental objective of preserving a natural market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors." *Id.* at 299.

The *Tracy* Court first found that the local utilities serve residential customers through monopolies that exist independent of the challenged law. *Id.* at 297–98, 302–03. For sales to consumers in these monopolies, the local utilities and the out-of-state marketers were not similarly situated because the entities did not and could not compete. *Id.* at 302–303. Accordingly, the Court held that "the dormant Commerce Clause has no job to do." *Id.* at 303.

The *Tracy* Court next found that the utilities did not have a monopoly with respect to the sale of natural gas to industrial consumers. *Id.* at 303. Here, at least, there was "a possibility of competition" between the private businesses and the local utilities, and thus the possibility of a dormant Commerce Clause violation. *Id.*

The Court framed the dispositive question as whether it should "accord controlling significance to the noncaptive market in which they compete, or to the noncompetitive, captive market in which the local utilities alone operate." *Id.* at 303–04. For three reasons, the Court held that it would give controlling weight to the monopoly market:

> First and most important, we must recognize an obligation to proceed cautiously lest we imperil the delivery by regulated [utilities] of bundled gas to the noncompetitive captive market. Second, as a Court we lack the expertness and the institutional resources necessary to predict the effects of judicial intervention invalidating Ohio's tax scheme on the utilities' capacity to serve this captive market. Finally, should intervention by the National Government be necessary, Congress has both the resources and the power to strike the balance between the needs of the competitive and captive markets.

Id. at 304. The Court emphasized: "Where a choice is possible, as it is here, the importance of traditional regulated service to the captive market makes a powerful case against any judicial treatment that might jeopardize [the utilities'] continuing capacity to serve the captive market." *Id.* Accordingly, the Court rejected the dormant Commerce Clause challenge. *Id.*

The Supreme Court has continued to acknowledge *Tracy*'s central premise that local energy utilities with monopolies are not similarly situated to private businesses for purposes of the dormant Commerce Clause. *See United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Management Auth.*, 550 U.S. 330, 342–43 (2007) (citing *Tracy*, 519 U.S. at 298 and *Tracy*, 519 U.S. at 313 (Scalia, J., concurring)); *see also Levin v. Commerce Energy, Inc.,* 560 U.S. 413, 429 n. 9 (2010) (citing *Tracy*, 519 U.S. at 279–80). Justice Scalia has observed that *Tracy* "effectively creates what might be called a 'public utilities' exception to the negative Commerce Clause." *Camps*

Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 607 (1997) (Scalia, J., dissenting).

The same analyses and reasoning that supported the dismissal of the dormant Commerce Clause claim in *Tracy* apply in this case.

This action involves LSP's claim that Minnesota's ROFR law favors local utilities over out-of-state transmission developers. Compl. ¶¶ 68, 85. The local utilities have monopolies with respect to the sale of electricity to consumers, because state law grants them exclusive service areas. Minn. Stat. § 216B.40; *see supra* at p. 2. For these sales, there is no competition. Accordingly, "the dormant Commerce Clause has no job to do." *Tracy*, 519 U.S. at 303.

However, as in *Tracy*, there is one area where the local utilities and out-of-state entities may compete: the building of electric transmission lines as part of the MISO regional planning process. LSP alleges it wants to compete against Minnesota's electric utilities here but is hindered by the ROFR law. Compl. ¶¶ 75–78.

The question is whether to accord controlling significance to this area of competition, or to the monopoly market for electricity distribution where the utilities alone operate. *Tracy*, 519 U.S. at 303–304. *Tracy* dictates that this Court grant controlling weight to the monopoly market.

The *Tracy* Court was concerned that, by striking down an alleged barrier to competition in a competitive area, it might impact the distribution of energy to consumers in a monopoly market. *Id.* at 304–305, 309. The *Tracy* Court acknowledged that it was "far more likely" that eliminating the barrier would not, on net, weaken the utilities'

position to serve consumers in the monopoly market. *Id.* at 307–308. Nevertheless, the Court determined that the mere possibility of a negative impact counseled against invalidating the law. *Id.* at 309. The *Tracy* Court emphasized "the importance of avoiding any jeopardy to service of the state-regulated captive market" for energy. *Id.* at 305.

The same rationale applies here. One FERC Commissioner dissented from FERC Order No. 1000 because of concerns that the elimination of the ROFR would jeopardize regional cooperation and the reliable distribution of electricity to consumers. *See supra* at pp. 3–4. The Minnesota legislature chose to avoid the uncertain effects from the elimination of the ROFR and instead opted to codify the status quo in state law. *See supra* at pp. 4–5. If this Court were to strike down Minnesota's ROFR law, it would inject uncertainty and risks into Minnesota's electric energy market. The Minnesota legislature passed the ROFR law to avoid these risks, and the *Tracy* Court unequivocally counseled against judicial intervention that might create such risks. *Tracy*, 519 U.S. at 304–305, 309.

Under *Tracy*, the monopoly market for electricity sales to consumers, where Minnesota's utilities have no competition, is entitled to greater weight than the market for building transmission lines, where the local utilities and developers may compete. Thus, Minnesota's utilities are not similarly situated to out-of-state transmission developers for purposes of the dormant Commerce Clause. Accordingly, the argument that Minnesota's ROFR law patently or overtly discriminates between local utilities and out-of-state transmission developers fails. *Id.* at 310.

B. LSP's Claim Also Fails The *Pike* Test.

Where a law is not patently discriminatory, it may still violate the dormant Commerce Clause if it fails the so-called *Pike* test—*i.e.*, if its burden on interstate commerce is "clearly excessive in relation to the putative local benefits." *Pike*, 397 U.S. 142. Laws that are not patently discriminatory have only been invalidated "where such laws undermined a compelling need for national uniformity in regulation." *Tracy*, 519 at 298 n. 12. In *Tracy*, the Court held that "the fact that Ohio exempts local utilities from its sales and use taxes could not support any claim of undue burden in this nondiscriminatory sense, since the exemption itself does not give rise to conflicting regulation of any transaction or result in malapportionment of any tax." *Id.*

Here, the Minnesota ROFR law also does not conflict with federal regulation and does not otherwise interfere with national uniformity goals. FERC, the agency charged by Congress with ensuring national regulation of electric markets, expressly stated that it was not preempting or otherwise limiting state ROFR laws. 136 FERC ¶ 61,051 at P. 227. FERC went further and approved the use of state ROFR laws in the regional transmission planning process. 150 FERC ¶ 61,037 at P. 18; Compl. ¶ 46. The Seventh Circuit upheld FERC's decision to approve the use of state ROFR laws. *MISO Transmission Owners*, 819 F.3d at 336.

Because Minnesota's ROFR law is consistent with federal transmission goals, as established by FERC, the law does not fail the dormant Commerce Clause's *Pike* test.

CONCLUSION

For all of the above reasons, Defendants respectfully request that this Court grant their motion and dismiss this action with prejudice.

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Respectfully submitted,

OFFICE OF THE ATTORNEY GENERAL
State of Minnesota

s/ Jason Marisam
JASON MARISAM
Assistant Attorney General
Atty. Reg. No. 0398187
445 Minnesota Street, Suite 1100
St. Paul, Minnesota 55101-2128
(651) 757-1275
jason.marisam@ag.state.mn.us

ATTORNEY FOR DEFENDANTS