No. 23-3857

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

INVENERGY THERMAL LLC AND GRAYS HARBOR ENERGY LLC,

Plaintiffs-Appellants,

v.

LAURA WATSON, IN HER OFFICIAL CAPACITY AS DIRECTOR OF THE WASHINGTON STATE DEPARTMENT OF ECOLOGY,

Defendant-Appellee.

On Appeal from the District Court for the Western District of Washington,
Honorable Benjamin H. Settle Presiding, Case No. 3:22-cv-05967-BHS

APPELLANTS' REPLY BRIEF

Vanessa Soriano Power
Jason T. Morgan
STOEL RIVES LLP
600 University Street
Suite 3600
Seattle, WA 98101
Telephone: (206) 624-0900
vanessa.power@stoel.com

Stephen D. Andrews
Nicholas G. Gamse
Michael J. Mestitz
Samuel M. Lazerwitz
WILLIAMS & CONNOLLY LLP
680 Maine Avenue, S.W.
Washington, DC 20024
Telephone: (202) 434-5000
mmestitz@wc.com

Attorneys for Appellants Invenergy Thermal LLC and Grays Harbor Energy LLC

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Pages(s)

CASES

OTHER AUTHORITIES

INTRODUCTION

Appellants Invenergy Thermal LLC ("Invenergy") and Grays Harbor Energy LLC ("Grays Harbor Energy") share Washington's stated aim of ensuring a green future. But the Act actually undermines that goal by *increasing* carbon emissions as a result of the disparate allocation of no-cost allowances, which distorts the local and interstate markets for electricity generation. These same market distortions will also raise electricity costs for Washingtonians.

The district court dismissed Appellants' claims on flawed grounds that are reversible for several independent reasons. As a sign of that decision's infirmity, Ecology disavows much of the district court's reasoning on appeal. It declines to defend the district court's *sua sponte* conclusion that Invenergy and Grays Harbor Energy lacked standing to assert almost all of their claims. Ecology Br. 16. Similarly, it admits that the district court misread the Supreme Court's decision in *National Pork Producers Council v. Ross*, 598 U.S. 356 (2023). Ecology Br. 41. Those issues alone are reason enough for reversal.

Ecology's efforts to bolster the district court's opinion as to other issues fail for several other reasons, including that they rest on factual assertions that contradict the allegations in the four corners of the Complaint. While Ecology may attempt to resolve such factual disputes through discovery, its motion for judgment on the pleadings "is not a procedure for resolving a contest between the parties about the

facts or the substantive merits of [Appellants'] case." *Chavez v. Blue Sky Nat. Beverage Co.*, 340 F. App'x 359, 360 (9th Cir. 2009) (citation omitted). At this stage, the Court "must accept all factual allegations in the complaint as true and construe them in the light most favorable to" Appellants. *Fleming v. Pickard*, 581 F.3d 922, 925 (9th Cir. 2009). Under this standard, the decision below should be reversed.

First, Appellants have stated claims that the Act unconstitutionally burdens interstate commerce under *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970). Ecology admits that *Pork Producers* allows challenges to even nondiscriminatory burdens, Ecology Br. 41, but argues that this Court should affirm the district court by prematurely conducting *Pike*'s fact-sensitive balancing. That is inappropriate on a 12(c) motion. The Complaint alleges that the Act's allocation of no-cost allowances distorts Washington's electricity market and burdens the interstate market for electricity and investment, while increasing both greenhouse-gas emissions and electricity prices for ratepayers. *See* ER-40–41, 58–64, 66. These allegations must be taken as true. Because the Act undercuts its own goals and fails to produce putative benefits, it violates the dormant Commerce Clause.

Second, Appellants have stated claims that the Act's allocation of no-cost allowances also unconstitutionally discriminates in violation of the dormant Commerce Clause and Equal Protection Clause.

Ecology advances several incorrect arguments, but contends primarily there is no "discrimination" under either theory because Appellants are not "similarly situated" to the Local Utilities. *E.g.*, Ecology Br. 23. But Ecology does not dispute that entities are similarly situated when they compete against each other, *see Rocky Mountain Farmers Union v. Corey*, 730 F.3d 1070, 1088 (9th Cir. 2013), and the Complaint alleges that, *as power-plant owners*, Appellants and the Local Utilities compete in the power-generation market, ER-36, 41, 43–44. Indeed, Ecology admits that "generating facilities owned and operated by" the Local Utilities "may . . . directly compete with" Appellants in this market. Ecology Br. 30.

Ecology also argues that the Local Utilities are "categorically dissimilar" from Appellants under *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997) because they sell electricity to ratepayers. Ecology Br. 30. But *Tracy* is distinguishable. The utilities there were not similarly situated to independent suppliers because the regulation in that case concerned the sale of natural gas to ratepayers—the monopolistic market in which only utilities participated. Here, by contrast, the Act's allocation of no-cost allowances affects a market that does not involve direct sales to ratepayers: the power-generation market, in which a utility can source power from its own plant or from Appellants' plant, the Grays Harbor Energy Center ("Grays Harbor"). This separate market *is* competitive, and the power plants the utilities own compete with Grays Harbor in it. ER-40–41, 43–44. As the Fifth

Circuit recently held in *NextEra Energy Capital Holdings, Inc. v. Lake* in rejecting a similar argument to the one Ecology makes here, "there is no 'public utilities exception' to the dormant Commerce Clause," and "a law addressing a single market . . . that is undoubtedly competitive . . . is not immune from Commerce Clause scrutiny" merely because a utility is involved. 48 F.4th 306, 320 (5th Cir. 2022), *cert. denied*, 144 S. Ct. 485 (2023).

At a minimum, despite Ecology's arguments to the contrary, the district court erred when it dismissed Appellants' claims with prejudice. Appellants had no opportunity to amend and could do so to cure any deficiencies, including by making additional allegations that the Act has distorted the interstate electricity market since Appellants filed the Complaint, and, in so doing, has increased electricity costs for consumers across the West. *See* Opening Br. 40–42, 56–57, 62.

Accordingly, this Court should reverse the dismissal with prejudice, vacate the district court's judgment, and remand for further proceedings.

ARGUMENT

I. ECOLOGY DOES NOT DISPUTE THAT INVENERGY AND GRAYS HARBOR ENERGY HAVE STANDING.

Ecology "does not defend the district court's dismissal" on standing. Ecology Br. 16. For all the reasons set forth in Appellants' opening brief, the district court erred in holding Appellants lacked standing, and this Court should vacate the jurisdictional portion of the opinion below. Opening Br. 21–35.

II. INVENERGY AND GRAYS HARBOR ENERGY STATED CLAIMS UNDER *PIKE*.

The district court erred in deciding that Invenergy and Grays Harbor Energy failed to state a claim under *Pike* when it concluded that "the Supreme Court recently rejected a similar argument" in *Pork Producers*. ER-20–21; Opening Br. 38–40. Ecology does not attempt to defend the district court's misreading of *Pork Producers*, and concedes that *Pork Producers* does not bar Appellants' *Pike* claims. Ecology Br. 40–42.

Instead, Ecology urges the Court to affirm dismissal by disregarding the well-pleaded burden on interstate commerce or by applying the *Pike* balancing test in the first instance on appeal based on materials outside the pleadings. *See* Ecology Br. 42–48. But "[t]he fact-intensive character" of *Pike* balancing "counsels against a premature dismissal." *Colon Health Ctrs. of Am., LLC v. Hazel*, 733 F.3d 535, 546 (4th Cir. 2013) (reversing dismissal of *Pike* claim). Appellants met their burden to state claims under *Pike* because they "plausibly alleg[ed]" the Act's allocation of no-cost allowances "places a 'significant' burden on interstate commerce," and that this burden "clearly outweighs [its] local benefits." *Rosenblatt v. City of Santa Monica*, 940 F.3d 439, 452 (9th Cir. 2019).

A. Appellants plausibly alleged that the Act's allocation of no-cost allowances unconstitutionally burdens interstate commerce.

Appellants plausibly allege that the Act significantly burdens interstate commerce because the Act's allocation of no-cost allowances distorts the energy market and, in doing so, hinders competition in Washington's and the wider Pacific Northwest's market for the generation of electricity. *See* ER-40–41, 58–61, 63, 66. As the Supreme Court made clear in *Pork Producers*, these allegations state a *Pike* claim. Appellants alleged that the law distorts the market for electricity, and that consumers will have to "pick up the tab." *Pork Producers*, 598 U.S. at 386 (plurality opinion).[1] That Washington's local incumbents benefit from the Act's obstruction of interstate (and intrastate) competition and investment only heightens the burden. *NextEra Energy*, 48 F.4th at 327–28 (allowing *Pike* claim where plaintiffs alleged the law effectively banned "new entrants" to the electricity transmission market); *Yamaha Motor Corp., U.S.A. v. Jim's Motorcycle, Inc.*, 401 F.3d 560, 573–74 (4th Cir. 2005) (holding that a statute violated *Pike* when the challenged law benefitted local incumbents and discouraged new market entrants). For these reasons, Appellants present significantly stronger claims than those in *Pork Producers*, which

[1] *See also id.* at 394 (Barrett, J., concurring in part) (burden adequately alleged when "costs are pervasive, burdensome, and will be felt primarily (but not exclusively) outside [the legislating state]"); *id.* at 397 (Roberts, C.J., concurring in part and dissenting in part) (burden adequately alleged when petitioners alleged "broader, market-wide consequences of compliance" (emphasis omitted))

alleged a mere increase in operating costs. *See* 598 U.S. at 386–87 (plurality op.); *id.* at 393 (Sotomayor, J., concurring in part). Ecology's arguments to the contrary are not persuasive.

First, Ecology insists that the Complaint does not allege the "specific facts" to demonstrate a substantial burden on interstate commerce. Ecology Br. 42–43. But the Complaint contains detailed allegations of how the Act distorts both the in-state and interstate markets for electricity. As the Complaint alleges, Appellants and Washington's Local Utilities—and many other entities both in and out of state—"participate in the [Pacific Northwest's] wholesale market" for electricity, generating power drawn by "thousands of entities across the Western Interconnection." ER-40–41. This web of power generation and purchase extends beyond Washington's borders and implicates the interstate supply of power.

A distortion to Washington's market for power generation affects how generating facilities sell energy onto this interstate exchange and how utilities purchase power from it. Because of the no-cost allowances the utilities receive—and can pass on to their wholly-owned power plants—no plant besides independently-owned Grays Harbor "must weigh the cost of allowances when deciding to generate electricity." ER-59. This distorts how the Local Utilities will source electricity, because the Local Utilities will dispatch "their less efficient plants, which benefit from no-cost allowances, rather than dispatch a more efficient

plant that must consider carbon costs when generating, such as Grays Harbor." ER-66. This, in turn, affects what is available both in- and out-of-state on the competitive wholesale market, to which Grays Harbor and Local Utilities' plants sell power, and from which the Local Utilities—and many other entities inside and outside the state—purchase it. *See* ER-40–41.

These market distortions will also obstruct the flow of interstate investment in natural-gas power plants in Washington, further insulating the Local Utilities from competition. ER-63. "No rational power company will enter" the market that the Act has distorted by imposing "a competitive disadvantage in the form of millions of dollars of increased costs each year" on entities who are not utilities while exempting the Local Utilities from these costs. ER-63. Appellants' allegations regarding these impacts are sufficient to state a claim. *See Colon Health Ctrs.*, 733 F.3d at 545–46 (holding appellants alleged a *Pike* claim by alleging the program "substantially burdens the interstate market for both medical devices and services"); *Levin Richmond Terminal Corp. v. City of Richmond*, 482 F. Supp. 3d 944, 956–57 (N.D. Cal. 2020) (holding that allegations that the challenged law "effectively preclude[d] the transport of coal and petcoke in interstate and overseas markets" sufficed to allege a substantial burden on interstate commerce).[2]

[2] Ecology argues without citation that Appellants did not plead any "projects cancelled." Ecology Br. 42–43. But there is no such requirement to state a plausible

Second, Ecology contends that the alleged burden does not satisfy *Pike* because the Act does not burden an "inherently national" activity or one that requires uniform regulation. Ecology Br. 43 (citation omitted). Ecology is wrong. The Pacific Northwest's wholesale market, described in detail in the Complaint, inherently crosses state lines. *See supra* pp. 7–8. As the Supreme Court has recognized, "the production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests." *Ark. Elec. Coop. Corp. v. Ark. Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983). The Act's distortion of the market for Washington's power generators affects this wider region.

Third, Ecology contends that Washington's efforts to make itself a less-attractive destination for all fossil-fuel generators cannot amount to a significant burden on interstate commerce. Ecology Br. 44. That argument misconstrues the Complaint's allegations. Appellants do not allege that the Act burdens interstate commerce merely because Washington seeks to promote greener electricity. Rather, Appellants allege that the Act's allocation of no-cost allowances burdens interstate commerce because Washington has effectively shut out interstate investment in

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Pike claim. And even if there were, that would at most support a dismissal *without* prejudice.

natural-gas power plants by rigging the state's market to favor the incumbent Local Utilities, who have a long-established history in the state and wield considerable political and economic power. *See* ER-44–45, 58–61, 63. These allegations must be taken as true. Regardless of whether an even-handed policy of dissuading all fossil-fuel electricity investment may survive dormant-Commerce-Clause scrutiny, Washington's obstruction of interstate investment to benefit of local incumbents cannot. *See supra* pp. 7–9.

Fourth, Ecology erroneously invokes *Pork Producers* to the minimize the significance of the Act's consequences on entities outside of Washington. Ecology Br. 44–45, 44 n.12. Although Ecology acknowledges that the Act will affect those outside of Washington, it suggests those effects hardly matter because the Act regulates "in-state activities." Ecology Br. 45. Here, Ecology seems to conflate Appellants' *Pike* claim with an "exterritorial effects" theory under the dormant Commerce Clause—a wholly separate theory. Regardless, where, as here, plaintiffs allege a burden on interstate commerce, their *Pike* claims "warrant[] the factual development that effects claims typically receive." *NextEra*, 48 F.4th at 327–28 (declining to dismiss *Pike* claim at the pleading stage); *Colon Health Ctrs.*, 733 F.3d at 546 (same); *Levin Richmond Terminal*, 482 F. Supp. 3d at 956–57 (same).

Fifth, Ecology's balancing analysis is wrong. Ecology contends it is irrelevant that no-cost allowances will increase emissions, because "the express purpose of

providing no-cost allowances to utilities is not to reduce emissions." Ecology Br. 46. That is a remarkable contention, given that Ecology elsewhere asserts that the Act aims "to substantially reduce Washington's greenhouse gas emissions in response to the existential threats posed by anthropogenic climate change." Ecology Br. 5; *see also* ER-49. Appellants' allegations that the no-cost allowance provision undermines this goal are sufficient to allege that Washington's claimed interests are "illusory." *Kassel v. Consol. Freightways Corp.*, 450 U.S. 662, 671 (1981); *see NextEra*, 48 F.4th at 327.

Ecology next argues that the Complaint does not allege that the allocation of allowances fails to serve its purpose of "mitigat[ing] the cost burden of the [Act's] program on electricity consumers." Ecology Br. 46–47 (citation omitted). Ecology, however, focuses on the wrong target. Appellants challenge Washington's decision to allocate no-cost allowances only to utilities. ER-70–71. And the Complaint alleges that this decision—to allocate no-cost allowances only to utilities—increases electricity prices compared to what prices would be if Washington allocated no-cost allowances to all power-plant owners, including Appellants. ER-66 (explaining how the current allocation of no-cost allowances "incentivizes utilities to dispatch their own power plants regardless" of the true costs and thereby increases electricity costs); ER-62 ("Ratepayers will be similarly harmed" in the form of increased electricity costs "by the incentives that the [Act's] allocation of no-cost allowances

produces".); ER-63 (allocating no-cost allowances to all power-plant owners "would prevent the [Act] from distorting the market" and, in turn, would help Washington "avoid significant costs"). Simply put, Washington's stated aim of mitigating the Act's price effects on ratepayers cannot to justify the state's decision to discriminate in favor of the Local Utilities, because, if Washington allocated no-cost allowances without discriminating, the cost to ratepayers would be even lower.[3]

B. Any dismissal should have been without prejudice.

Even if Appellants failed to state claim under *Pike*, this Court should vacate the district court's judgment and instruct the court to dismiss the claims without prejudice, to allow Appellants to amend. Despite Ecology's arguments to the contrary, amendment would not be futile. *Contra* Ecology Br. 52–53.

Ecology fundamentally argues that Appellants inadequately pleaded their *Pike* claims, so Ecology's position shows that Appellants could replead them to state a claim. Unlike Ecology's other arguments, which assert that Appellants' discrimination claims "fail[] as a matter of law," Ecology Br. 21, 49 (capitalization altered), Ecology argues only that "[Appellants] fail[] to plausibly allege a claim

[3] Ecology also argues that the Act serves to advance "public health and safety." Ecology Br. 47–48. "But the incantation of a purpose to promote the public health or safety does not insulate a state law from Commerce Clause attack." *Kassel*, 450 U.S. at 670. Ecology's gestures to the Clean Energy Transformation Act's ("CETA") significance prove unconvincing for the reasons explained below. *See infra* pp. 18–20.

under *Pike*," *id.* at 39 (capitalization altered). And Ecology identifies supposed inadequacies in Appellants' pleading, all of which could be remedied by amendment. *See id.* at 42–43, 46, 48.

The case was dismissed on the eve of Appellants' submission of an expert report that would have shown the effects of the Act's allocation of no-cost allowances on the Washington and interstate markets for power generation and electricity. Opening Br. 41. Ecology does not dispute Appellants' proffer that this expert analysis would support additional allegations of how the Act's allocation of no-cost allowances increases greenhouse-gas emissions (harming the environment) and electricity prices (harming consumers). Ecology, nevertheless, argues that this report would merely "state[] the obvious" by showing the Act increases costs for natural-gas power plants in Washington, Ecology Br. 53, but it fails to explain why additional analyses could not plausibly demonstrate that the Act unduly burdens interstate commerce, especially when these analyses would show how no-cost allowances affect competition and electricity prices in interstate markets, *see* Opening Br. 41.

Further, the Act has now affected electricity markets for over a year, and from this experience, Appellants can allege new facts that show, among other things, increased generation by plants owned by Local Utilities, increased prices for electricity in the wider Pacific Northwest's wholesale and retail electricity markets,

and the absence of transfers of no-cost allowances to Appellants. Such allegations would further demonstrate how the Act's allocation of no-cost allowances unduly burdens interstate commerce by favoring the Local Utilities, hindering the ability for Appellants and new entrants to compete, and by making electricity less green and more expensive for Washingtonians and others in the Pacific Northwest.

III. INVENERGY AND GRAYS HABOR ENERGY STATED A CLAIM FOR DISCRIMINATION UNDER THE DORMANT COMMERCE CLAUSE.

A. Appellants plausibly pleaded that the Act discriminates in effect against out-of-state power-plant owners.

Ecology does not dispute the standard for unconstitutional discrimination under the dormant Commerce Clause. A statute may unconstitutionally discriminate by (1) denying foreign entities "beneficial [regulatory] treatment;" (2) taking away "competitive and economic advantages" foreign entities have earned; or (3) causing foreign entities to supply less of the relevant product to the state's market and local entities to supply more. Opening Br. 45–46 (citations omitted).

Nor does Ecology dispute that discrimination under the dormant Commerce Clause does not require that the benefited class be composed entirely of local entities, nor the burdened class be composed entirely of foreign entities. *Id.* at 53, 56. And Ecology offers no response to the cases confirming that courts generally assess a statute's discriminatory effects only after discovery. *Id.* at 43.

Lastly, despite arguing at length that Appellants and the Local Utilities are not similarly situated, *see* Ecology Br. 23–31, Ecology does not contest that whether entities are similarly situated under the dormant Commerce Clause turns on whether they "compete against each other in a single market," Opening Br. 44 (citation omitted), and admits that "generating facilities owned and operated by" the Local Utilities "may . . . directly compete with [Appellants] in the wholesale market," Ecology Br. 30.

Under the undisputed governing law, Appellants have plausibly pleaded that the Act's allocation of no-cost allowances unconstitutionally discriminates against Appellants as out-of-state power-plant owners. By allocating no-cost allowances only to one class of power plant owners, the Local Utilities, and not to independent power producers like Appellants, the Act effectively allocates allowances among similarly situated power-plant owners based on their connection to Washington. ER-58–61, 68–69. The generating facilities owned by the Local Utilities and Appellants compete against each other to generate and supply power for distribution downstream, ER-36, 41, 43–44, and the disparate allocation of no-cost allowances among similarly situated power-plant owners benefits in-state interests by, among other things, distorting dispatch decisions in Washington and the wider regional electricity market, *e.g.*, ER-60, 66.

Ecology argues that utilities receive the benefits of no-cost allowances in order to serve ratepayers, not generators. Ecology Br. 38. But, as the Complaint alleges, the Local Utilities will use their allowances to cover their power plants' obligations under the Act. ER-59. Indeed, the Act permits the Local Utilities to transfer no-cost allowances to their own facilities without any limitation. ER-55, 59. That the Act provides the no-cost allowances to the Local Utilities in the first instance has no bearing on the effects-focused inquiry under the dormant Commerce Clause, because the effects are felt in the power-generation market.

Ecology also claims that the Local Utilities could theoretically transfer their no-cost allowances to Grays Harbor. Ecology Br. 38. But, the Complaint's allegations, which must be accepted as true, show, in practice, such transfers will not occur. ER-55–56, 59. As Appellants alleged, the Act makes it *harder* for utilities to transfer allowances to Grays Harbor than to their own plants. Under the Act, utilities may transfer allowances to a generator they own without restriction, yet they may transfer allowances to independently owned plants like Grays Harbor, only if they enter into a "power purchase agreement." ER-55. Neither the Act nor its implementing regulations provide any guidance about what types of agreements are sufficient to allow the transfer of allowances. ER-55. And, in discovery, Ecology conceded that it could not identify any such agreements.

Finally, Ecology argues that any benefits of the transfer of allowances accrue to the benefit of ratepayers, but that is incorrect. Ecology Br. 38. The Act requires that the utilities use the revenues from transfers to benefit ratepayers directly only when they consign their no-cost allowances to auction. WAC § 173-446-230(6). When the utilities transfer no-cost allowances to their own plants, they receive the benefits by erasing their plants' compliance obligations. ER-59–60. This does not serve ratepayers. Instead, as a result of the allocation of no-cost allowances, ratepayers will pay *more* for electricity than they would have had the Act allocated no-cost allowances to all power-plant owners. ER-62–63, 66. Indeed, even before the Act's first compliance period, the Local Utilities had already begun to seek significant rate increases, ER-62, and Ecology tacitly admits that electricity prices will rise now the Act is in place, Ecology Br. 47, 50–51.

B. Appellants are similarly situated to the Local Utilities—and compete with them—in their shared capacity as power-plant owners.

Ecology argues that the Act's allocation of no-cost allowances does not discriminate against Appellants because they are not similarly situated to the Local Utilities. Ecology Br. 23. Entities are similarly situated under the dormant Commerce Clause, as Ecology does not dispute, when they compete against each other. *See supra* p. 15. Appellants alleged they compete with the Local Utilities in their shared capacity as owners of power plants who sell electricity—either for

distribution to ratepayers or on the wholesale market. ER-36, 41, 43–44. Ecology's concession that utility-owned power plants "may also directly compete with [Appellants] in the wholesale market," Ecology Br. 30, only reinforces this well-pleaded allegation.

Moreover, whether the Local Utilities are treated differently for their activities as electric utilities has no bearing here, because the Act does not regulate the Local Utilities in their status as utilities. Opening Br. 48–49. Ecology admits the Act "largely exempts utilities from its scope" and instead regulates "*all* power facilities in Washington, regardless of whether they are owned by a utility." Ecology Br. 1. In other words, the Act regulates utilities insofar as they own power plants, and, as power-plant owners, they are no different than Appellants. ER-64–65.

Ecology, nonetheless, insists that the Local Utilities' obligations under CETA justify their preferential treatment under the Act. Ecology Br. 25–26. But, as the Complaint alleges, the Act and CETA regulate distinct areas of Washington's electricity sector. The Act regulates the emissions that *power generators* produce by capping Washington's total emissions and requiring generators to pay for the emissions they produce. ER-49–50. CETA, by contrast, regulates how *utilities* supply electricity to ratepayers, requiring the electricity they supply to their customers be greenhouse-gas neutral by 2030 and emissions-free by 2045. ER-47. As Ecology puts it, "[the Act] seeks to cover those electricity sector emissions that

[CETA] does not reach." Ecology Br. 1. But even that is misleading, because CETA, unlike the Act, does not regulate emissions from the production of electricity. Instead, CETA requires utilities to *supply*, not *produce*, less-emission-intensive electricity to ratepayers. ER-47. In short, both the Act and CETA make clear they regulate distinct aspects of the electricity markets, impose distinct obligations, and give rise to distinct rather than duplicative compliance costs for the entities covered under these statutes.[4]

Ecology further argues that allocating Appellants no-cost allowances would give them an unfair advantage. Ecology Br. 26–27. Not so—it would let Grays Harbor play on a level playing field with other power generators (who also lack CETA obligations of their own). As Ecology admits, utilities "purchase power from the wholesale market from independent power plants such as [Appellants'] facility" in order to supply ratepayers, Ecology Br. 8 n.1, and, as the Complaint alleges, most of Grays Harbor's electricity serves Washington, ER-42. Under the Act, when a utility-owned plant supplies a utility with electricity that ultimately serves ratepayers, that power plant may benefit from its owner's no-cost allowances. Appellants seek the same treatment for itself and Grays Harbor.

[4] In fact, discovery materials demonstrate that Ecology and others involved the Act's drafting understood that the Act's obligations were distinct from, and did not duplicate, CETA's obligations. Were this necessary to plead, Appellants could amend to do so.

C. *Tracy* confirms that Appellants and the Local Utilities are similarly situated.

Ecology also contends that Appellants are not similarly situated to the Local Utilities under *General Motors Corp. v. Tracy* because the Local Utilities participate in a regulated, monopoly market. Ecology Br. 27–31. *Tracy* supports the opposite conclusion.

In *Tracy*, the petitioners alleged Ohio's tax laws unconstitutionally discriminated against interstate commerce on their face because they exempted the sales of the state's natural-gas utilities, but not the sales of other natural-gas suppliers, from the state sales tax. 519 U.S. at 282–83. The utilities and the independent suppliers, however, primarily operated in two different markets and sold different products. *Id.* at 301–03. The utilities largely sold "bundled gas," in the state's regulated monopoly market in which they faced no competition, while the independent suppliers sold only "unbundled gas" in a competitive market in which utilities peripherally participated. *Id.* at 293–98, 301–03.

The key question before the Court therefore was which market was relevant for dormant Commerce Clause purposes. *See id.* at 303–04. The Court gave greater weight to the regulated, monopoly market in which the utilities faced no competition because, in that case, the monopoly market was the "core market" at issue. *Id.* at 301; *see id.* at 303–09. Accordingly, the Court held that the utilities and independent suppliers were not similarly situated because they primarily sold two different

products (bundled and unbundled gas) in two different markets, and the state law applied primarily to the non-competitive market. *See id.* at 297–98, 303–04, 310.

Tracy is instructive here, but not for the reasons Ecology suggests. The Act's allocation of no-cost allowances operates in a competitive market (the power-generation market), not a monopoly market (the retail electricity market). Appellants' generating facility (Grays Harbor) and the Local Utilities' plants produce the same good—energy supplied onto the grid, where utilities can dispatch it to ratepayers or other entities can purchase it. *See* ER-40–41, 43–44. In the competitive market for power generation, Ecology admits that the generating facilities that Appellants and the Local Utilities own compete and supply power to utilities to sell to ratepayers. *See supra* pp. 15, 19.

The Fifth Circuit explained how *Tracy* applied in an analogous scenario in *NextEra Energy*. There, the court considered whether a Texas law that permitted only local utilities to build certain electricity transmission lines unconstitutionally discriminated against interstate commerce. *NextEra Energy*, 48 F.4th at 310. Like Ecology here, the state agency argued that, under *Tracy*, the utilities were not similarly situated to the independent transmission companies because they participated in a monopoly market. *Id.* at 318–20. The court rejected this argument because "[t]he statute limiting who can build transmission lines governs only a competitive market," and, in the relevant transmission market, "vertically integrated

utilities and transmission-only companies compete and offer the same services: building, operating, and owning transmission lines." *Id.* at 319. That reasoning applies with equal force here.

Critically, the Act regulates Appellants and Local Utilities for their actions in the competitive market for power generation, *i.e.* for their actions as power-plant owners. *See supra* p. 18. Although utilities receive no-cost allowances based on the amount of electricity they supply to ratepayers, that is no more determinative than the fact that the law in *NextEra Energy* authorized only utilities to construct transmission lines. The effects of the Act are felt in the competitive generation market, because power-plant owners must obtain allowances to cover their generators' emissions regardless of where that electricity is ultimately supplied. ER-49–50. No-cost allowances benefit the Local Utilities as power-plant owners because they may erase their generators' obligations. ER-49–50. Indeed, under the Act, the Local Utilities may use their allowances to offset any emissions their generators produce, even those produced generating electricity for sale outside of Washington. *See* WAC § 173-446-230(6). Thus, because the Act's allocation of no-cost allowances does not operate in "a 'noncompetitive, captive market in which the local utilities alone operate,'" and, instead addresses an "undoubtedly

competitive" market, the Local Utilities and Appellants are similarly situated. *NextEra Energy*, 48 F.4th at 319–20 (quoting *Tracy*, 519 U.S. at 303–04).[5]

D. The allocation of no-cost allowances in practice benefits the Local Utilities and burdens Appellants.

Ecology argues that Appellants' claims rest "on the mistaken assumption that utility-owned power plants will receive no cost allowances for sales on the wholesale market," and maintains that "utilities are no different than [Appellants] when it comes to the wholesale market," by which Ecology appears to refer to sales of electricity to entities other than utilities. Ecology Br. 31–32. Not so.[6] The Complaint alleges, the Act's allocation of no-cost allowances advantages the Local Utilities as power-plant owners even with respect to the electricity generated and dispatched to ratepayers. ER-59–60; s*ee supra* pp. 7–8, 15–16. And the Act advantages utilities when they sell others because utilities can use their allowances

[5] Nor does any incidental effect the Act may have on the monopoly market justify its impermissible discrimination in the competitive market: "If a state law's propping up a utility in a noncaptive market to enhance its viability in a captive market created immunity from Commerce Clause scrutiny, then a state could grant in-state utilities the exclusive right to operate coal mines in the state (or, for that matter, the exclusive right to sell ice cream in the state)." *NextEra Energy*, 48 F.4th at 320. Both *Tracy* and *NextEra* make plain that "there is no 'public utilities exception' to the dormant Commerce Clause." *id.* (citing *Tracy*, 519 U.S. at 291 n.8).

[6] Appellants did not concede that the market to generate electricity that utilities ultimately supply to ratepayers is irrelevant to their claims. *Contra* Ecology Br. 32–33.

to erase their power plants' compliance obligations—even for power generated that is sold outside Washington. ER-59–60. As a result, the Local Utilities gain an advantage in the non-retail electricity market, too. *See* ER-59–60.

E. The Act discriminates in effect against out-of-state interests.

Ecology contends that the Act does not discriminate because it does not expressly distinguish between in-state and out-of-state power-plant owners. Ecology Br. 33–34. But Appellants have alleged the Act discriminates *in effect* by allocating allowances to in-state power-plant owners, the Local Utilities, who have a specific type of connection to and presence in Washington—being a utility and serving ratepayers. The Act simultaneously denies no-cost allowances to similarly situated power-plant owners, who lack a similar connection to and presence in Washington.

Ecology relies on a bevy of facts not properly considered at the pleading stage. To show the Act does not allocate allowances based on a power-plant owner's connection to Washington, Ecology points to PacifiCorp. Ecology Br. 34, 36. But PacifiCorp qualifies as an in-state entity because it maintains a significant local presence in Washington: it is one of only three investor-owned utilities in the state, operates in a highly regulated market as an electric utility, employs many individuals within Washington, and possesses power within the state's politics. ER-40, 45 & n.9; SER-35; *see* Ecology Br. 8–9, 24. Ecology offers no argument why these

connections to the state are insufficient to make PacifiCorp 'local' for dormant-Commerce-Clause purposes. Even if PacifiCorp were considered an out-of-state entity, Ecology does not dispute that a law may still discriminate against out-of-state entities even if the favored group is not entirely composed of in-state entities. *See Walgreen Co. v. Rullan*, 405 F.3d 50, 58–59 (1st Cir. 2005).

Instead, Ecology attempts to minimize the significance of *NextEra Energy* by labeling it inapposite to "[non]-in-state presence case[s]." Ecology Br. 35.[7] But the Act effectively imposes an in-state presence requirement by distributing no-cost allowances among power-plant owners only to the incumbent Local Utilities, which maintain significant operations in the state and submit to significant state regulation for their utility activities. ER-60–61, 68. Ecology claims that any entity "with zero existing presence in Washington" could purchase an existing utility or "petition the UTC to create a new utility." Ecology Br. 36. But that is a red herring: Appellants do not allege that the Act discriminates on its face, they allege that it discriminates in effect. And in practice, Ecology's suggestion is fanciful—establishing a new

[7] Ecology ignores the Eleventh Circuit's decision in *Florida Transport Services, Inc. v. Miami-Dade County*, where the court adopted "a functional approach" to in-state or out-of-state classification. 703 F.3d 1230, 1259 (11th Cir. 2012). There, the court reasoned that a port's permitting practices favored local businesses because these practices favored incumbents that "were operating locally at the Port or were otherwise entrenched at the Port." *Id.*

utility is a burdensome and highly regulated process.[8] This demonstrates why the Act's distinction amounts to a local presence requirement—a new power-plant owner must either enter a market with insurmountable barriers to entry, or buy one of the three *local* companies that already exist (which is also a barrier to entry).[9]

Ecology also claims that the Act is nondiscriminatory because two of Washington's public universities do not receive no-cost allowances. Ecology Br. 38–39. This argument has no basis in the Complaint nor any material properly considered at the pleading stage. Those universities are irrelevant because the record contains no allegations, evidence, or findings that they compete against Appellants and the Local Utilities as power-plant owners.[10] They are therefore not similarly situated, and do not preclude Appellants' claims. *See supra* p. 15.

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[8] Ecology's suggestion that a Washington company like Microsoft could "commission an independent natural gas power plant" is similarly an argument about facial discrimination. Ecology Br. 36. As the Complaint alleges, no corporation would undertake this expense without an ownership interest in the Local Utilities because the Act distorts the market, making it more challenging for any independent plant owner to compete against the incumbent utility-owned plants, discouraging any foreign investment or competition. ER-58–61, 63.

[9] Ecology argues for the first time on appeal that Appellants should also be considered in-state entities. Ecology Br. 37. But that ignores the Complaint's well-pleaded allegations that Appellants maintain an appreciably smaller presence in Washington. ER-45. And because the argument was not raised in the district court below, it is doubly inappropriate to consider here.

[10] Contrary to Ecology's claim, Ecology Br. 38, the district court erred in taking judicial notice of disputed facts about the university-owned power plants—that those plants produced the majority of the universities' emissions, that those emissions

F. Any dismissal should have been without prejudice.

Even if the Complaint fails to state discrimination claims under the dormant Commerce Clause, the district court erred in dismissing Appellants' claims with prejudice. Appellants could allege additional facts to show that they are similarly situated to the Local Utilities, that the Act's allocation of no-cost allowances advantages the Local Utilities in the market in which they compete against Appellants, and that the Act benefits in-state power-plant owners and burdens out-of-state ones. Opening Br. 56–57.

Ecology claims that amendment would be futile because the Local Utilities, like Appellants, must procure allowances to cover greenhouse-gas emissions for electricity they generate that is not dispatched to ratepayers. Ecology Br. 52. That the Act allocates no-cost allowances to utilities based on the electricity the utilities anticipate supplying to ratepayers does not foreclose Appellants' claims. *See supra* pp. 23–24.

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resulted from their generation of electricity, and that the plants competed against Grays Harbor, *see Khoja v. Orexigen Therapeutics, Inc.*, 899 F.3d 988, 999–1000 (9th Cir. 2018). And Ecology compounds the improper factual dispute by making the non-record assertion that these plants generate both heat and electricity, Ecology Br. 38–39, 39 n.9, while public reporting suggests that the plants primarily generate heat and devote, at most, a small proportion of their activities to generating electricity, *see* Calder Stenn, *UW Power Plant Provides Essential Services for University*, The Daily, Mar. 1, 2022, https://www.dailyuw.com/news/governance/uw-power-plant-provides-essential-services-for-university/article_898da3d8-984a-11ec-aa85-e38b8204c263.html.

Ecology next suggests that Appellants could not demonstrate they are similarly situated to the Local Utilities. Ecology Br. 52. For all the reasons explained above, *supra* pp. 17–23, Ecology misreads the law. And if any additional allegations about competition in the wholesale market are necessary, Appellants can provide them.

Finally, Ecology asserts that Appellants could not show the Act's allocation of no cost allowances has any relation to "economic protectionism." Ecology Br. 52. That, too, is wrong. Appellants could plead additional facts that show the Act's allocation of no-cost allowances favors in-state power-plant owners, including the advantages Local Utilities have accrued in practice. Moreover, Appellants could allege additional facts confirming that, despite their best efforts, Appellants have been unable to obtain no-cost allowances from the Local Utilities through power purchase agreements. And if any additional facts are needed regarding PacifiCorp or the universities, Appellants can allege additional facts regarding their presence in Washington or whether they are similarly situated.

IV. INVENERGY AND GRAYS HARBOR ENERGY STATED AN EQUAL PROTECTION CLAIM.

The district court erred in dismissing Grays Harbor Energy's equal-protection claim for failure to state a claim. ER-32–33. Appellants plausibly pleaded that the Act discriminates against independent power-plant owners by denying this class of power-plant owners the no-cost allowances it allocates to the Local Utilities. ER-

64–65; *see supra* pp. 15–16. Appellants also plausibly pleaded that Washington lacks a rational justification for this discrimination because the disparate allocation of no-cost allowances hinders the Act's aims of reducing greenhouse-gas emissions and mitigating electricity price hikes in the coming decades. ER-65–67; *see supra* pp. 11–12.

Ecology's arguments here are similar to its arguments about the dormant Commerce Clause, and fail for the same reasons. First, Ecology asserts that Appellants are not similarly situated to the Local Utilities. Ecology Br. 50. As explained above, the distinctions upon which Ecology relies are irrelevant. *See supra* pp. 17–23. The Equal Protection Clause prohibits discrimination among groups that are similarly situated in the aspects relevant to the challenged law. *See Gallinger v. Becerra*, 898 F.3d 1012, 1016 (9th Cir. 2018); *Ariz. Dream Act Coal. v. Brewer*, 855 F.3d 957, 966 (9th Cir. 2017). The Act regulates utilities as power-plant owners, a fact which even Ecology cannot dispute. *See supra* p. 18; Ecology Br. 1 ("[The Act] largely exempts utilities from its scope."). And, as power-plant owners, Appellants and the Local Utilities are similar in all relevant respects. ER-64–65; *see supra* pp. 17–19.

Second, Ecology contends that the Act's allocation of no-cost allowances is rationally related to Washington's determination that allowances are necessary to avoid duplicating utilities' obligations under CETA and ensuring that ratepayers "do

not see dramatically increased energy costs from that duplication." Ecology Br. 50. Neither of those claims withstands even the government-friendly scrutiny of rational-basis review. There are no duplicative obligations because CETA's and the Act's obligations are distinct, and regulate different aspects of Washington's electricity sector. *See supra* p. 19 & n.4. The allocation of no-cost allowances similarly is untethered to Washington's goal of preventing increased electricity costs for ratepayers because Ecology's chosen allocation will *increase* electricity prices over what a nondiscriminatory allocation would accomplish. *See supra* pp. 11–12.

Even if the Complaint fails to state an equal-protection claim, the district court erred in dismissing with prejudice because amendment would not be futile. Appellants could plead additional facts that demonstrate how utilities participate in the power-generation market and are therefore similarly situated to Appellants in all relevant respects under the Act. Opening Br. 62. Appellants could also plead additional facts that detail how the allocation of no-cost allowances affects retail electricity prices and distorts the electricity market and utility dispatch decisions. In response, Ecology largely offers glib hyperbole that does not show that amendment would be futile. Ecology Br. 53–54.

CONCLUSION

For the foregoing reasons, Appellants respectfully request that this Court reverse the dismissal with prejudice of Appellants' claims, vacate the District Court's judgment, and remand for further proceedings.

Dated: May 10, 2024

Respectfully submitted,

/s/ Michael J. Mestitz

Stephen D. Andrews
Nicholas G. Gamse
Michael J. Mestitz
Samuel M. Lazerwitz
WILLIAMS & CONNOLLY LLP
680 Maine Avenue, S.W.
Washington, DC 20024
Telephone: (202) 434-5000
mmestitz@wc.com

Vanessa Soriano Power
Jason T. Morgan
STOEL RIVES LLP
600 University Street
Suite 3600
Seattle, WA 98101
Telephone: (206) 624-0900
vanessa.power@stoel.com

Attorneys for Appellants Invenergy Thermal LLC and Grays Harbor Energy LLC

CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32(g), and 9th Circuit Rule 32-1, I certify that this brief complies with applicable type-volume and length limitations because this brief contains 6,985 words, excluding the items exempted by Federal Rule of Appellate Procedure 32(f).

This brief complies with the typeface and typestyle requirements of Fed. R. App. P. 32(a)(5)-(6) because it has been prepared in a proportionally spaced typeface using Microsoft Office Word for Office 365 in 14-point font.

/s/ Michael J. Mestitz
Michael J. Mestitz

CERTIFICATE OF SERVICE

I, Michael J. Mestitz, counsel for appellants and a member of the Bar of this Court, certify that, on May 10, 2024, a copy of the attached Reply Brief of Appellants was filed with the Clerk and served on the parties through the Court's electronic filing system. I further certify that all parties required to be served have been served.

/s/ Michael J. Mestitz
Michael J. Mestitz

Dated: May 10, 2024