SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF SARATOGA

INDECK CORINTH, L.P.

Petitioner/Plaintiff,

- against -

DAVID A. PATERSON, as Governor, NEW YORK STATE DEPARTMENT OF ENVIRONMENTAL CONSERVATION, NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY, and NEW YORK STATE PUBLIC SERVICE COMMISSION

Respondents/Defendants.

Index No: 2009 369

RJI No. 2009/0369

Hon. Thomas D. Nolan, Jr.

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I. INTRODUCTION AND SUMMARY

Usurpation of authority, violation of separation of powers and arbitrary imposition of regulations are not justified by a worthy goal, including specifically the goal of reducing emissions of greenhouse gases. Petitioner/Plaintiff Indeck Corinth, L.P. ("Indeck") filed this proceeding to vindicate its rights to be taxed only upon the proper authority of the New York State Legislature; and to assure that environmental policies that impose significant costs on Indeck, and on New York's citizens and consumers of electricity, are adopted through statutes passed by the State Legislature, rather than by mere executive fiat and the arbitrary action of administrative agencies that have substituted unauthorized interstate compacts for the proper exercise of discretion. Indeck seeks to assure that actions of the Respondents/Defendants are properly cabined and reviewed.

New York State agreed with nine other Northeastern states (the ten states together, the "Compact States") to implement the "Regional Greenhouse Gas Initiative" ("RGGI"), a joint program to reduce greenhouse gases. The Compact States agreed to limit (and over time reduce) carbon dioxide ("CO_2") emissions from electric generation stations by allowing only a certain number of tons of CO_2 to be emitted across the region (with each such permitted ton represented by certificate, or "allowance," that only the Compact States would issue). The Compact States agreed to enforce that limitation by requiring the generators to purchase the "allowances" necessary to match their actual emissions. In this way, the Compact States would (1) require generators to "internalize" the true costs of power generation by adding a regulatory cost (the cost of the allowances) that the generators would pass through in pricing for such power; and (2) raise substantial amounts of money to be used for public purposes, including some related to greenhouse gases.

While the other nine Compact States obtained appropriate legislative authority to engage in this effort, the Governor of New York and the other Respondents/Defendants imposed it by executive fiat, establishing a costly and highly significant regulatory taxing and expenditure program which has never received the slightest authorization from the New York State Legislature. However laudable the underlying goal, it cannot cure the usurpation of power, nor the vice of the regulations as they apply to Indeck—perversely obligating Indeck to purchase the allowances, but refusing to allow it to reflect that cost in the price of the electricity generated.

The Respondents/Defendants, by unlawfully and without proper authority joining in the "RGGI Agreement" and then promulgating regulations to implement RGGI within New York on the terms agreed under the unlawful interstate compact, usurped the proper constitutional role and authority of the State Legislature to determine policy and to impose taxes. The Department of Environmental Conservation ("DEC") and the New York State Energy Research and Development Authority ("NYSERDA") arbitrarily, capriciously and without lawful authority, improperly adopted implementing regulations, without exercise of their own discretion, choosing to accept wholesale, a program drafted under an unlawful interstate compact rather than looking to the only proper source for their authority: the statutes passed by the New York State Legislature. Through those unlawful regulations, DEC imposed an unauthorized tax, the revenue from which is to be expended by NYSERDA at its whim, with no statutory program to guide it, and with no control or oversight by the State Legislature. The New York Public Service Commission ("PSC"), rather than adhering to the obligations imposed by federal law and its proper role under New York law properly to balance the needs and interests of both power producers and consumers, abdicated its responsibility to do so.

Because the Respondent/Defendant Governor Paterson and the Respondent/Defendant agencies never even sought, much less obtained, authorization from the New York State Legislature for their entry into, participation in and adoption of the RGGI Agreement and its regulatory program, they violated constitutional limits and other obligations. They compounded that violation of authority and separation of powers by surrendering the proper scope of their own discretion to an unlawful multi-state compact. As a result, a laudable policy goal of controlling greenhouse gas emissions has been perverted such that clean, low emitting generating stations will suffer financial and other injuries, emissions of greenhouse gases will likely increase, and electricity costs to New York and other consumers will rise for no environmental or other benefit.

The RGGI agreement and the regulations promulgated thereunder exceed the authority of the Governor acting alone, and exceed the existing statutory authority otherwise granted to DEC and NYSERDA by the Legislature. The New York State Constitution provides for a strict separation of powers between the Executive and Legislative branches, granting to the Legislative branch the sole authority to set policy, and to approve and adopt agreements or compacts with other states. Only the State Legislature, and then only in compliance with the relevant constitutional provisions, may impose taxes, and only the Legislature may appropriate state funds. Contrary to these strictures, the core of separation of powers, the New York Governor's office has initiated, drafted, and executed the RGGI Agreement, and then required the agencies to adopt subsequent greenhouse gas regulations. By those actions, the Governor and the agencies imposed unlawful taxation through a cap and trade auction, all in blatant disregard of the limitations of the executive branch's authority. These actions unlawfully usurp the power of the Legislature to the injury of Indeck, and to the detriment and expense of the

people of New York, who bear the burden of the cost of the RGGI program. Without the requisite statutory authorization, New York's participation in RGGI is unauthorized and unlawful.

Moreover, RGGI, through the auction of allowances, imposes an unlawful tax and establishes an unauthorized revenue fund without the required appropriation or approval by the Legislature. Even if DEC had general authority regarding environmental programs and emission limitations, DEC cannot, by executive fiat, establish a tax. This power vests solely in the New York Legislature under the New York Constitution. DEC and NYSERDA claim that the revenues generated by the program "do not constitute a tax . . . New York will use the auction proceeds to cover its share of the cost of the RGGI program." Administrative Record ("AR") 17 at 49.[1] That claim woefully misstates the true financial effect: the three RGGI auctions have to date raised an astounding $262,314,303, of which New York's share is $87,956,663. *See* www.rggi.org/states/auction_proceeds. Hundreds of millions of additional dollars will be raised in auctions yet to come. By the agencies' own description in the record, the auction was intentionally designed to create a pool of money, exceeding the administrative and enforcement cost of the program, to fund various environmental programs. AR 17 at 1-7. Fees, which aim to cover the cost of programs, cannot be more than "reasonably necessary to cover the costs of issuance, inspection and enforcement." *Health Services Medical Corp. of Central New York, Inc. v. Chassin*, 175 Misc. 2d 621, 625, 668 N.Y.S.2d 1006, 1010 (Sup. Ct. 1998), *aff'd*, 259 A.D.2d 1053, 689 N.Y.S.2d 875 (4th Dep't 1999). By DEC's and NYSERDA's own admission, the costs of the program are less than 10% of the revenue the auction process generates. AR 17 at 171-72.

[1] Citations to the Administrative Record filed in this proceeding are in the form "AR __ at __." citing to the item number as set forth in the Index to the administrative record and then the page number(s) within that document.

Rather than being used to cover the costs of issuance, inspection and enforcement, New York's portion of the auction proceeds will be distributed by NYSERDA at its whim, without any legislative appropriation or approval. The features of the RGGI program—the mandatory allowance auction, the generation of funds well beyond the administrative and enforcement costs, and the declared intention of NYSERDA to use the funds as it sees fit—demonstrate that the Defendants/Respondents Governor and agencies have used RGGI to impose an unlawful administrative tax. Because there is no specific legislative authorization, the imposition of the allowance program as a fund raising tool, the auction program, NYSERDA's receipt of auction proceeds and its retention of those funds for its own purposes, are illegal and void *ab initio*.

Moreover, the Compact States have created an impermissible and unconstitutional "regional agreement" to regulate greenhouse gases. Without approval from the United States Congress, RGGI is an unconstitutional compact which encroaches on federal power and supremacy. The U.S. Constitution specifically requires Congressional approval of interstate compacts prior to their becoming effective, especially those that increase the compacting states' power at the expense of the Federal Government. RGGI, as "the first mandatory, market based effort in the U.S. to reduce greenhouse gas emissions", infringes on the Federal Government's domestic and international interests in regulating greenhouse gas emissions and interstate commerce. Because DEC surrendered its discretion and authority to an interstate group, DEC failed or refused to consider (and continues to refuse to consider), tailoring the Model Rule to the specific circumstances of New York power generators.

Finally, RGGI, as implemented by NYSERDA and DEC, is arbitrary and capricious as applied to the specific circumstances of Indeck. The RGGI regulations require that

all affected sources of CO_2 to purchase allowances at auction or in the trading market. Thus, New York imposes on Indeck a cost of a likely minimum of $2,500,000 annually, but irrationally discriminates against Indeck and a few other facilities by foreclosing them (and only them) from any opportunity to recover the cost of the allowances required to be purchased.

This distinction has no rational basis. Under RGGI, the sources pay for allowances at a market-determined price, thus assuring that such sources internalize costs and that their prices reflect the full cost of producing electricity, including CO_2 emissions. Those costs are then passed through the chain of power distribution, so that decisions as to which plants will be "dispatched" to generate power are based on a fully-internalized cost (including the cost associated with CO_2 emissions), and ultimately users of power will consider that cost in determining the amounts of power to consume. Thus, conservation and alternative sources of power are properly priced in relation to use of fossil-fueled generation, and there is no incentive to increase output of some units as a result of improper price signaling. By imposing the cost of purchasing allowances on Indeck but barring recovery of that cost, the RGGI regulations necessarily price Indeck's power below others by at least the cost of allowances, creating improper signals to both immediate purchasers and ultimate consumers. That result discriminates against Indeck and the few other similarly situated owners and, as discussed in Section III.F below, violates the requirement of the Public Utilities Regulatory Policies Act ("PURPA") that purchasers of electricity from "Qualifying Facilities" or "QFs" such as Indeck to pay the full avoided cost of such power. Such an irrational regulatory scheme, involving a specific discriminatory decision, is not only arbitrary and capricious but also violates due process.

While the DEC regulations impose a cost burden on Indeck, the PSC has instructed DEC to refuse to include provisions to permit Indeck to adjust its power contract to recover the costs. In adopting the state regulations to implement PURPA, New York State promised that qualifying facilities would recover their full avoided cost. The DEC's arbitrary regulations imposing such costs, combined with the PSC's and DEC's refusal to contemplate an opportunity for Indeck to recover such costs, is a taking of Indeck's property in violation of the federal and state constitutions.

To remedy these circumstances and vindicate the rights of Indeck and the people of New York, this Court must declare that RGGI, as adopted and implemented by the Respondents/Defendants, (i) is unlawful *ab initio* because the Governor lacked and continues to lack the authority to enter into the RGGI Compact without legislative approval; (ii) imposes an unauthorized and unlawful tax by executive fiat and without proper legislative authorization; (iii) creates an unauthorized spending program, giving unfettered discretion to a public benefit corporation to disburse hundreds of millions of dollars with no involvement, authorization or appropriation by the State Legislature in violation of the New York Constitution; (iv) is an unlawful interstate compact because it lacks the Congressional authorization constitutionally required under Article I, Section 10, Clause 3 of the U.S. Constitution; and (v) arbitrarily, capriciously and unlawfully imposes an unfair and discriminatory cost upon Indeck, while preventing Indeck from having a fair opportunity to recover that cost.

II. STATEMENT OF FACTS

A. Indeck Corinth

Indeck owns and operates a 131-megawatt ("MW") gas-fired combined cycle cogeneration facility located in Corinth, New York. Verified Joint Pet. & Compl. [hereinafter

"Pet."] ¶¶ 3, 23. In operation, the facility burns natural gas, a clean-burning, low-emitting fossil fuel, in a combustion turbine. *Id.* The exhaust gases from the combustion turbine and the heat associated with those gases are used to produce electricity and steam. The steam is separately put to useful purposes, and the electricity sold to a utility for delivery to a customer in New York.[2] *Id.* The Corinth facility is among the lowest emitting—*i.e.*, least polluting—generation facilities in New York State. Its power is sold pursuant to a contract approved by the PSC in 1989, and amended in 1993, under the terms of PURPA.[3] Pet. at ¶¶ 24-29.

The revenues Indeck receives from its sale of power are used to pay its lenders for the cost of having constructed the facility, to pay staff, fuel costs and similar operating expenses, and (if there is a surplus) to provide profits to its owners. As described in more detail below, the RGGI program, as adopted by New York, substantially increases the costs of Indeck's operation of the facility (by requiring Indeck to purchase "allowances" equal to its emissions of CO_2). The cost increase will likely be a minimum of $2.5 million annually. AR ___ (Letter from Indeck to Governor Paterson, August 19, 2008 attached hereto as Exhibit A).[4] While imposing these costs, the regulations bar Indeck from any opportunity to recover them, and thus impose a deadweight revenue loss for all current and future periods for which the regulations apply. Pet. at ¶¶ 24-29.

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[2] It is the production of both useful thermal energy and electricity that qualifies the Corinth facility as a "cogenerator", and the relative efficiency of that production that allows it to qualify under PURPA. Pet. ¶ 24.

[3] Consistent with the provisions of PURPA and its implementing regulations, the price paid to Indeck under the contract approved by the PSC has two components – a "capacity" payment and an "energy" payment. The "capacity" payment covers the value associated with the generation unit being available and ready to produce electricity. That value is separate from the actual cost of producing power. In practical terms, the capacity payment is used to cover the debt associated with having constructed the facility and is primarily devoted to debt service. The "energy" payment covers the value associated with producing and delivering electric power moment-by-moment as the plant operates. Indeck's energy prices are fixed under the PSC contract in relation to certain fuel and other costs determined by the utility purchaser, and are generally consistent with (and usually lower) than the costs of power in the markets operated by the New York ISO. The purchasing utility's decision to require the plant to operate (to "dispatch" the unit) is based on the energy cost, not the total price (capacity and energy) or the capacity price. In making that decision, the utility compares the Indeck price to other sources, including the ISO markets, and takes into account its expected need for energy in later time periods, reliability of supply and other factors. Pet. at ¶¶ 24-29; *see also* Independent System Operator Agreement, June 22, 2007 (*available at* http://www.nyiso.com/public/webdocs/documents/regulatory/agreements/nyiso_agreement/iso_agreement.pdf).

[4] This exhibit will be added as part of the administrative record pursuant to the parties' agreement attached as

Recognizing that the costs were significant, and that as proposed the RGGI program would substantially and detrimentally affect it, Indeck participated actively in the administrative process. *See, e.g.*, AR 55, 89, 89, 98, 100-01, 104, 129, 198, 204 & 226. However, because the Governor's agreement to enter into and participate in the RGGI program obligated DEC to adopt the Model Rule developed by the RGGI organization, DEC refused to give reasonable consideration to the circumstances of Indeck and the other units similarly situated. As a result, it refused to adopt provisions that would have (a) reduced or eliminated the unfair and discriminatory results of the Model Rule, and (b) expressly fulfilled the underlying economic principles that DEC uses to support its regulatory determination. Upon promulgation of the final regulations, Indeck timely filed this hybrid proceeding, raising both statutory claims (including those under Article 78) as well as claims arising under the U.S. and New York Constitutions.

Because its Corinth Facility is among the cleanest, lowest-emitting generating facilities in New York, Indeck would be advantaged by a properly conceived, properly implemented program to control or reduce greenhouse gases. Indeed, the long-term strategy of Indeck's controlling shareholder, Indeck Energy, is to own and operate facilities that are based on renewable or other clean, "green" fuels. *See* www.indeckenergy.com/companyProfile.php. Indeck brought this action because RGGI as implemented in New York violates Indeck's rights and is not properly conceived. Because of DEC's arbitrary decisions, the RGGI program as implemented is likely to increase, not decrease, overall CO_2 emissions and impose high costs with no proper benefit.

Exhibit B.

B. The RGGI Program

In April of 2003, then-Governor Pataki invited the governors of other northeast states to join together in a regional compact aimed at controlling greenhouse gas emissions. AR 244. As a result of this invitation, the Compact States agreed to a joint effort to limit or reduce greenhouse emissions within a ten-state area through a "cap and trade" control program. AR 245. This "historic regional agreement" was codified in the RGGI's "Memorandum of Understanding" ("MOU") on December 20, 2005. *Id.* Under this MOU, the Compact States committed to make concerted and coordinated efforts to limit and ultimately to reduce the emissions of "greenhouse gases" within their geographic territory. The Compact States undertook their joint and concerted agreement rather than waiting for federal action to establish a national program to control greenhouse gases across all states and regions.

In the MOU, the Compact States set forth goals and established certain procedures and structures to develop and implement the program. *Id.* They established a baseline of CO_2 emissions, using data of actual emissions in historic periods. *Id.* at 2-3. To cap and ultimately reduce those emissions, they agreed to use an "allowance" mechanism—each affected source of CO_2 (for these purposes currently all electric generating stations of more than 25 MW in capacity throughout the ten State region) would be required to hold each year a number of certificates equal to its actual CO_2 emissions for that year. *Id.* at 6-7. The Compact States would limit the number of such certificates to be issued and available at any time, and thus require the sources to limit their overall emissions to the number of certificates ("allowances") made available for the period. *Id.*

To implement the agreed scheme, the RGGI organization established by the Compact States sets an overall limitation on CO_2 emissions in tons per year and allocates that total limitation among the States based on their historic emissions. *Id.* Each Compact State, in

turn, issues yearly a number of "allowances"—tradable certificates allowing the emission of one ton of CO_2 that year—equal to the Compact State's specific cap for that year. AR 245 at 6-7. Facilities subject to the RGGI program must acquire sufficient allowances to equal their actual emissions. The certificates are "tradable" across the entire ten-State region to allow efficient facilities to profit from their ability to control or reduce emissions, and to allow others to speculate or profit on emission levels and the "value" of the tradable allowances. *Id.* In order to capture the economic benefit associated with the tradability of the allowances, the Compact States auction the allowances in a market run by the RGGI, Inc., a non-profit corporation established to provide administrative and technical services in support of RGGI. *Id.* at 7-8.

To provide a staff and other resources that could implement the basic decisions, the Compact States formed a Working Group made up of representatives from the affected regulatory agencies in each State. AR 250. The Working Group, through its efforts and the suggestions and actions of consultants hired by it, developed a model rule (the "Model Rule") for implementation by the Compact States. AR 243. Each Compact State agreed to promulgate its own regulations matching the Model Rule. AR 245.

Each Compact State, except New York, obtained express statutory authorization to implement the RGGI cap and trade program and to implement the Model Rule. *See, e.g.*, 2007 Conn. Pub. Acts No. 07-242; DEL. CODE ANN. tit. 7, §§ 6043-6047 (2008); 2008 Me. Laws Chs. 317, 608; MASS. GEN. LAWS ch. 25A, §§ 6, 13 (2007); 2009 N.H. REV. STAT. § 125-O:19 *et seq.*; N.J. STAT. ANN. § 26:2C-37 *et seq.* (2007); 2007 R.I. Pub. Laws 23-82; VT. STAT. ANN. tit. 30, § 254 (2007); MD. CODE ANN., ENVIR. § 2-1001 (2008).

Unlike all the other Compact States, the New York Governor's office chose to implement the cap and trade program and auction process through regulations without seeking

statutory authorization. AR 17 at 1. At no time, prior to or since the inception of RGGI, has the Legislature authorized the entry into the MOU, authorized the regulatory program embodying the promulgation or implementation of the Model Rule, or authorized the receipt, distribution or other use of the funds required to implement RGGI or raised by its auction program. Instead, DEC and NYSERDA claim the program is lawful under "its broad authority to use all available methods to prevent and control air pollution." *Id.*

Because allowances have an enforced scarcity (a limited number is issued for any period, and that number is less than the total potential emissions of CO_2 in the region), allowances have a value. There are different methods by which the allowances could have been initially made available to affected sources. AR 24. For example, under similar federal programs to address acid rain-related emissions, allowances are given by the government to affected sources. No initial payment is involved, although the sources may profit from the potential trading. *See* 42 U.S.C. § 7401 *et seq.*; 40 C.F.R. § 72 *et seq.*

Initially, the Model Rule and the Working Group contemplated that allowances would be allocated to sources on a similar basis, through an allocation mechanism to be determined. AR 195 at 2. However, very late in the process of developing the Model Rule, the Compact States decided to sell the allowances to sources (or any other qualified purchaser) in order to prevent emitting sources from obtaining and retaining the value of the allowances. The auction process instead transfers the value to the State for public use, and in theory allows the Compact States to leverage the consumption effects a proper price signal would create. AR 243. At the urging of some stakeholders and on the basis of analysis by consultants, the Compact States agreed to a centralized auction process with certain characteristics that would be used as the initial pricing, sale and distribution mechanism. *Id.* First, all Compact States would

periodically contribute all their allowances available for general use into a single auction pool. *Id.* The RGGI Organization would then periodically conduct open bid auctions at which allowances would be purchased by bidders at a single market clearing price established for that auction. *Id.* Any person could participate in the auctions, seeking to buy allowances to use, to trade or sell, or to retire them in order to reduce the total amount of CO_2 that can be emitted in the Compact States. AR 205.

C. New York's Implementation Of RGGI

The MOU and the Model Rule specifically contemplate that each Compact State would seek and obtain all authority necessary under applicable state law to conduct the program contemplated by the Model Rule. AR 243 & 245. New York, alone among the Compact States, did not obtain statutory authorization from its State Legislature. Rather, the Governor and agencies chose to implement the program solely by promulgation of executive agency regulations. AR 17 at 1. DEC and NYSERDA promulgated regulations to impose a system under which DEC would create and issue New York's allocated share of allowances, and NYSERDA would sell them and receive all proceeds. N.Y. COMP. CODES R. & REGS. tit. 6, § 242 ("CO_2 Budget Trading Program"); N.Y. COMP. CODES R. & REGS. tit. 21, § 507 ("CO_2 Allowance Auction Program"). Under these rules, DEC issues allowances and places them exclusively in an "account" managed by NYSERDA. *See* N.Y. COMP. CODES R. & REGS. tit. 6, § 242-5.3. NYSERDA, in turn, contributes the allowances in the account to the centralized auction process as it occurs. *See* N.Y. COMP. CODES R. & REGS. tit. 21, § 507.4. All of the proceeds from the sale of New York's allowances in each auction flow back to the NYSERDA account. *Id.* Under the promulgated rules and without any legislative authority, NYSERDA will distribute the monies received as a result of the auction for any purposes in its sole and

unfettered discretion and without legislative guidance or authority. *Id.* Because the structure of the auction results in a single uniform "market clearing" price, all available allowances for the particular auction are sold at that price, and New York allowances may be sold to persons within or without the State, and to persons who may or may not be owners or operators of affected facilities. *See* N.Y. COMP. CODES R. & REGS. tit. 21, § 507.8.

Under the regulations promulgated by DEC to implement RGGI, each electric generating station in New York that is larger than 25 MW in generating capacity and which emits CO_2, is subject to RGGI requirements. *See* N.Y. COMP. CODES R. & REGS. tit. 6, § 242-1.4. Each such station must have one allowance for each ton of CO_2 emitted during the relevant time period. *See* N.Y. COMP. CODES R. & REGS. tit. 6, § 242-1.5(c). To acquire the allowances, each source is required either to buy them during the auction process, or to later trade for or buy them, paying the price set by the trade or selling counterparty. Each such source must have a compliance account with DEC and is required to have in its account the appropriate number of allowances of the proper year to cover the source's emissions for the relevant time period. *Id.*

As of the date of this filing, RGGI has held three centralized auctions; New York participated in two, one in December 2008 and one in March 2009. NYSERDA submitted more than twelve million allowances to the December auction and more than 13 million allowances to the March auction. *See* www.rggi.org/states/auction_proceeds. At the December auction, the market clearing price (*i.e.*, the price at which all allowances in the auction were sold) was $3.38 per ton. *Id.* In the March 2009 auction, the 2009 vintage allowances[5] market clearing price was $3.51 per ton, and the 2012 vintage allowances market clearing price was $3.05 per ton. *Id.* The

[5] The March 18, 2009 auction was the first auction to offer "vintages" of allowances. Vintages allowances purchased can be used in the relevant control period. The 2009 vintage allowances sold in the March auction can be used during the 2009 to 2010 control period, but the 2012 vintage allowances can only be used in the 2012 to 2014 control period. http://www.rggi.org/states/auction_proceeds.

cumulative proceeds to date from the auctions for the RGGI program exceed $262.3 million, and New York's share is $87,956,663 to be disbursed by NYSERDA in its unfettered discretion, with no authorization or appropriation by the New York Legislature. *Id.* Market observers generally predict that the market clearing price will increase in future auctions, and that as a result, NYSERDA will in future years receive more than $149 million[6] annually in auction proceeds, all to be disbursed by NYSERDA at its unfettered discretion, with no authorization or appropriation by the New York Legislature.

D. The New York Legislature Has Not Authorized Any Aspect Of RGGI.

The Legislature did not authorize the entry into the MOU by the then-Governor, and has not authorized, approved or consented to the MOU at any time since the execution of the MOU. The Legislature has not authorized DEC to create a tradable allowance program to control greenhouse gases and has not authorized DEC specifically to regulate emissions of CO_2 by electric generating plants. It has not authorized or set as State policy the RGGI Model Rule as implemented by DEC. *See generally* AR 17 at 1.

Neither has it authorized the auction process as implemented by DEC and NYSERDA. The Legislature has not authorized DEC to issue greenhouse gas allowances, nor has it authorized DEC to issue such allowances to NYSERDA for sale in a centralized auction. The Legislature has not authorized NYSERDA to sell those greenhouse gas allowances in an auction. Finally, the Legislature has not authorized NYSERDA's receipt of auction revenues. *Id.*

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[6] Initial modeling estimates put the allowance price at $2.32. AR 1 at 9. The base budget for allowances for the period of 2009 to 2014 is 64,310,805 annually. N.Y. COMP. CODES R. & REGS. tit. 6, § 242-5.1. To date, the highest market clearing price has been $3.51 (*see* http://www.rggi.org/states/auction_proceeds), providing NYSERDA with funds of $225,730,925 annually.

Although under long standing New York precedent, establishing policy for the State is a quintessential legislative function, the Legislature has issued no policy that authorizes the distribution of auction proceeds to NYSERDA, and has not appropriated or otherwise established a policy for the use of funds received by New York as a result of the sale of allowances. NYSERDA has not been authorized to spend the nearly $88 million dollars already generated by the auction in its unfettered discretion. In fact, the Legislature has not authorized the participation of *any* state administrative agency in the implementation of the RGGI program, including but not limited to the issuance and sale of allowances and the receipt and use of the proceeds from the sale of allowances. *Id.* The only greenhouse gas legislation passed by the Legislature—a bill to fund an environmental task force to review greenhouse gas policies—was vetoed by then-Governor Spitzer in January of 2007. AR 17 at 15-16.

E. The Agencies' Claim Of Statutory Authority

DEC and NYSERDA acknowledge that there is no specific statutory authorization for RGGI. AR 17 at 1-5. DEC claims that these regulations are authorized by a variety of general statutory pronouncements, including New York's stated policy "to maintain a reasonable degree of purity of the air resources of the state" and "to require the use of all available practical and reasonable methods to prevent and control air pollution in the state[.]" N.Y. ENVTL. CONSERV. LAW § 19-0103. DEC also proffers the Legislature's generic grant of authority to "adopt and promulgate...codes and rules and regulations for preventing, controlling or prohibiting air pollution in such areas of the state as may be affected by air pollution[.]" *Id.* at § 19-0301.1(a).

This generic grant of rulemaking authority, similar to rulemaking authority granted to other state agencies, has never been found to authorize the creation of an entire

regulatory scheme outside the ambit of any pre-existing federal or state law. In fact, the existing authority in this area suggests strongly that such a grant of authority cannot be implied. Certainly, such a generalized grant of authority has been found sufficient to allow DEC to implement rules consistent and in conformity with a federal statutory scheme. *See, e.g., Motor Vehicle Mfrs. Assn v. Jorling*, 585 N.Y.S.2d 596, 181 A.D.2d 83 (3d Dep't 1992). It has also been found adequate to sustain the Department's power to ban the sale in commerce of pollutants that it has determined to be injurious to public health. *See Oxygenated Fuels Ass'n v. Pataki*, 293 F. Supp. 2d 170 (N.D.N.Y. 2003). Unlike those circumstances, where the general grant is used to allow the state to comply with federal requirements, it is clear that the federal act provides no comfort and indeed that binding interpretations of federal law do not support unauthorized cap and trade programs.

At the federal level, where attempts have been made to establish regulatory cap and trade systems through executive authority, they have been struck down. For example, in *North Carolina v. Envtl. Prot. Agency*, the Court initially vacated and on rehearing adhered to its reversal of the rule and remanded, the Clean Air Interstate Rule ("CAIR") which attempted to impose a regional cap and trade program to reduce the impact of up-wind sources on out-of-state down-wind receptors. 531 F.3d 896, 902, 382 U.S. App. D.C. 134, 144 (D.C. Cir. 2008), (*reh'g in part*, 550 F.3d 1176 (D.C. Cir. 2008)) (the Court vacated initially but on rehearing reversed the rule as outside EPA's authority and remanded without vacating). Similarly, in *New Jersey v. Envtl. Prot. Agency*, the D.C. Circuit Court of Appeals vacated the Clean Air Mercury Rule ("CAMR") that capped mercury emissions through the issuance of allowances as a means of reducing mercury emissions through a cap and trade program. *See* 517 F.3d 574, 584, 380 U.S. App. D.C. 134, 144 (D.C. Cir. 2008).

As noted in *Concerned Homeowners of Rosebank v. New York Power Auth.*, "DEC regulations are to be read in conjunction with the Federal Clean Air Act." 2001 N.Y. Slip Op. 40096(U), No. 8164/01, 2001 WL 940258 (Sup. Ct. July 9, 2001); *see also* Practice Commentaries McKinney's ENVTL. CONSERV. LAWS § 19-0301. Existing federal and New York State air programs do not incorporate the issuance of allowances or a cap and trade regulatory structure unless authorized by the Legislature. To read the generic grant of rulemaking authority in § 19-0301 as permitting the establishment of a cap and trade system imposing hundreds of millions of dollars of costs on regulated entities, and generating hundreds of millions of dollars in fees for regulatory agencies to spend in their unfettered discretion, would be unprecedented in either New York State or federal jurisprudence.[7]

NYSERDA's mandate is to develop and implement new energy technologies and promote energy conservation. N.Y. PUB. AUTH. LAW § 1854. NYSERDA has the powers: (1) to research, develop and demonstrate new energy technologies; (2) to provide services required for the development and use of new energy technologies; (3) to advise the legislature of recommendation for implementing new energy technologies and energy conservation measures; (4) to coordinate the state's administration of any energy or energy resource programs of the federal government; and (5) to advise and assist the governor and the legislature in the development and implementation of state policies relating to energy. *Id.* In furtherance of its research-and-technology-oriented mandate, it has the power, *inter alia*, to sponsor research, provide services, coordinate energy resource programs, and advise the Governor and the

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[7] Notably, CAIR and CAMR each excluded cogeneration units such as Indeck's from compliance with the cap and trade requirements that EPA sought to impose through those regulations. *See* 40 C.F.R. § 72.6(b)(4) [Title IV]; 40 C.F.R. § 96.102, 96.104 [CAIR]; 40 C.F.R. § 60.4102, 60.4104 [CAMR].

Legislature regarding energy policy. *Id.* It has the standard grant of authority to promulgate rules and regulations in furtherance of those goals. *Id.* at § 1855.

Notably absent from NYSERDA's enumerated powers is the authority to create or administer a statewide regulatory scheme, to issue or withhold permits, to conduct auctions, to raise millions of dollars from regulated entities, or to expend funds so raised on projects of its unilateral choosing. Nor is there any regulatory precedent or case law support for implying such powers from those set forth in NYSERDA's governing statutes. As with DEC, NYSERDA is asking this Court to interpret a limited grant of power from the Legislature in a breathtaking and unprecedented fashion.

F. The Economic Theory Of Allowances

New York determined to use an auction process to distribute allowances based on economic theory and analysis. *See* AR 24-3, 205, 243, & 245. Under this theory, if affected sources receive allowances without cost, but allowances have value, the sources will nonetheless include the value of the allowances in pricing their product (here, electricity). AR 205. Thus, the affected sources will receive additional revenue generally equal to the value of the allowances. *Id.* That revenue can be used for the costs of reducing emissions or to provide other incentives. *Id.* Because the pricing from the sources is expected to include the value of allowances, downstream purchasers will see a price signal reflecting the allowance value, incentivizing them to adjust their consumption of electricity accordingly. AR 24-3, 173, 174, 176, & 205. If, however, the costs of the allowances are not passed through, the incentive properly to adjust consumption and make appropriate choices among power producers is lost.

Pressed by some commentators and consultants, the Compact States determined that an allowance auction, rather than a direct grant of allowances to emitting sources, would

better assure the proper economic signals at all levels. AR 24 & 24-3. Sources would be required to pay for allowances; thus, all affected sources would have the same price signal on the relative cost of emitting a ton of CO_2 and would internalize that cost. Sources would then pass that cost through to their customers (or be unable profitably to remain in business). This internalization of the allowance cost assures downstream purchasers would see the full proper price signal rather than a diluted one. AR 205. Furthermore, the centralized auction ensures that the revenues raised flow directly into the Compact States' coffers to be used by the States for designated government programs, including assisting affected consumers, increasing funding for conservation or other programs or general state purposes. *See* N.Y. COMP. CODES R. & REGS. tit. 21, §§ 507.3, 507.4.

In promulgating the RGGI rules, DEC expressly noted that the program is premised on the assumption that electrical generation sources will include the cost they incur to acquire allowances in the rates charged for electricity they generate. AR 23 at 11, 25. In general, for the unit producing the marginal supply, the cost to produce electricity will increase by the cost of allowances. AR 205. As a result of the operation of a market process conducted by the New York Independent System Operator ("NYISO"), this increased cost will be reflected in the price received by virtually all generators, allowing them an opportunity to recover the cost of allowances. AR 17 at 251-54. Indeed, generators who do not need allowances (*e.g.*, nuclear or hydroelectric generators), and generators located outside of the RGGI area who are not bound by RGGI but who bid to serve the New York market, will see their revenues and gross profits rise by an amount equal to the cost of the allowances, even though they will not bear that cost. AR 23 at 25.

G. RGGI And The New York Electric Markets

In general, utilities or others providing electricity to consumers or users in New York acquire the electricity needed to serve electric demand through the NYISO market process. The ISO market establishes a "clearing price" for electricity based on bids submitted by generators—*i.e.*, those who produce power or those who can reliably reduce demand. That clearing price is then generally paid for all electricity in that hour, except for power subject to pre-existing contractual arrangements. The market clearing price is generally set by the marginal units that burn fossil fuels, which are required to purchase RGGI allowances. Since these units are required to purchase and have sufficient RGGI allowances for their emissions, the market clearing price for electricity in each hour will likely reflect the cost of the CO_2 allowances. AR 17 at 27-28; *see also* Independent System Operators Agreement, June 22, 2007 (*available at* http://www.nyiso.com/public/webdocs/documents/regulatory/agreements/nyiso_agreement/iso_agreement.pdf).

While any particular unit may have higher or lower allowance costs than the marginal unit and may have higher or lower costs of generation overall, it is expected that the marginal unit, and therefore the market clearing electricity price, will include allowance costs. AR 205. The general electricity market operated by the NYISO thus assures that those generators who receive the NYISO market price will have a fair opportunity to recover allowance costs. Those costs in turn will be passed on to consumers of electricity by those electric utilities that provide retail electric service.

H. Procedural History

During the DEC and NYSERDA rulemaking process, Indeck and other similarly situated QFs actively participated and properly raised for agency consideration the issues addressed by this Petition and Complaint. *See, e.g.*, AR 55, 86, 89, 98, 100, 101, 104, 129, 198,

204, & 226. The agencies received comments specifically raising the issue that the New York Legislature had not authorized the RGGI program, had not authorized the sale of allowances, and had not authorized NYSERDA's receipt and distribution of auction revenues. *See* AR 17. Indeck specifically raised the issue that the proposed auction methodology imposed on it, and a few additional similarly situated entities, a significant new operating cost that could not be recovered. Furthermore, Indeck, a supporter of programs to control greenhouse gases, advanced several different proposals by which this result would be avoided, including an allocation of allowances or a mechanism to allow cost pass-through. *See* AR 55, 89, 98, & 100. Despite Indeck's repeated requests, PSC instructed DEC that PSC was unwilling to mandate a pricing change in the electricity contract to accommodate the dramatically increased cost that Indeck would bear, and which would be imposed by agency rules. Pet. at ¶¶ 28-29.

DEC's rules do have a limited "safety valve" allocation of allowances to plants subject to long term fixed price contracts. AR 17 at 304; N.Y. COMP. CODES R. & REGS. tit. 6, § 242-5.3. However, that program fails to set aside enough allowances to permit all affected facilities subject to long-term contracts to receive the allowances necessary to operate, and fails to assure that such facilities adversely affected by the PSC refusal to direct cost pass-through will have a fair opportunity to obtain allowances or to recover the cost of allowances necessary to operate. AR 17 at 304, 311; N.Y. COMP. CODES R. & REGS. tit. 6, § 242-5.3.

III. ARGUMENT

RGGI, as currently implemented in New York, is irretrievably flawed. It is void *ab initio*, lacks any proper basis in law, unlawfully imposes taxes and unlawfully distributes general revenues. Furthermore, the New York state agencies acted unlawfully and arbitrarily in promulgating these regulations. The inception of RGGI, the manner in which New York

agencies have chosen (or have been directed by the Governor) to implement the promulgated regulations give rise to a litany of violations, including the following:

- New York initiated a multi-state compact and joined that compact with no authority or approval from the State Legislature.
- The multi-state compact also violates federal constitutional requirements, encroaching on the federal government's power and lacking approval by the U.S. Congress.
- RGGI, as implemented in New York, imposes a tax purely by administrative fiat, and with no authorization or oversight by the State Legislature.
- RGGI, as implemented in New York, devolves upon NYSERDA significant sums of general revenue – exceeding $149 million annually – to be distributed by NYSERDA at its unfettered whim, with no direction by or accounting of the funds to the Legislature or adherence to its priorities for the use of such funds.
- DEC's process in promulgating the regulations abdicated its discretion to an interstate working group, and was thereby arbitrary and capricious.
- DEC's regulations are arbitrary and capricious as they apply to Indeck and other similarly-situated facilities under long-term supply contracts, in that they discriminatorily deny Indeck the ability to pass through the cost of purchasing allowances that is available to virtually all other generating plants, and that denial has economic and environmental effects that directly undercut the underlying goals and rationale of the RGGI program.
- As promulgated, the regulations are an unlawful breach of Indeck's rights and statutorily-based expectations. Under federal law and existing regulations, New York

assured Indeck and other qualifying facilities of their right to receive the full avoided cost of the power they produce, and Indeck relied on those assurances in investing in and developing the Corinth Plant. Under the regulations as promulgated, New York has breached those commitments, to Indeck's substantial and ongoing injury.

- The PSC acted in concert with DEC implementing its unlawful scheme. Carefully avoiding making any regulatory decisions, the PSC has instead enunciated ad hoc policies and taken other unlawful and discriminatory actions to the injury of Indeck.

A. The Governor's Commitment Of New York State To The RGGI MOU Is An Unauthorized Action And Is *Ultra Vires*.

In entering into the RGGI MOU, the Governor acted outside of his express constitutional power and has usurped the power of the Legislature. The Governor's responsibility is to implement policies determined by the Legislative branch. Specifically, the New York Constitution states that

> The governor shall communicate to the legislature at every session the condition of the state, and recommend such matters to it as he or she shall judge expedient. The governor shall expedite all measures as may be resolved upon by the legislature, and shall take care that the laws are faithfully executed.

N.Y. CONST. art. IV, § 3.

The Court of Appeals of New York has repeatedly underscored that a fundamental distinction exists in authority between the Legislature and the Governor. New York's Constitution specifically vests separate powers to each of the branches of the State's government. "The separation of powers 'requires that the Legislature make the critical policy decisions, while the executive branch's responsibility is to implement those policies.'" *Saratoga County Chamber of Commerce, Inc. v. Pataki*, 100 N.Y.2d 801, 821-22, 766 N.Y.S.2d 654, 666 (2003) (quoting *Bourquin v. Cuomo*, 628 N.Y.S.2d 618 (1995)) [hereinafter "*Saratoga III*"].

In *Saratoga III*, the Court refused to uphold the Tribal-State Compact between the St. Regis Mohawk tribe and New York State, entered into by the Governor, on the basis that the Governor had not sought the approval of the Legislature. The Court acknowledged that under federal law, Indian tribes were permitted to enter into compacts with the States to allow gambling, and that the compacts were to resolve matters such as taxation, gaming operations and other regulations relating to gambling. *Id.* at 656. However, the Court held that entering into such a Compact required approval by the State Legislature, because decisions involving gambling were policy decisions and were thus the responsibility of the Legislative branch under the New York Constitution. *Id.* at 667-68.

According to the *Saratoga III* Court, the Legislature is the only source of State policy. *Id.* at 668. The Governor executes policy, and, while he can make recommendations, he does not establish policies without the participation and authorization of the Legislature. *Id.* at 666-67. Decisions involving fundamental policy choices, such as licensing, taxation, and the choice of which state agency to administer a law "require a balancing of differing interests, a task the multimember, representative Legislature is entrusted to perform under [New York's] constitutional structure." *Id.* at 667. Because agencies are the "creatures of the Legislature," agencies may perform only those duties expressly assigned by the Legislature or required by necessary implication. *Id.* at 668.

The RGGI Compact makes policy decisions regarding the regulation and taxation of CO_2 emissions. Policy decisions, such as environmental concerns, that affect the health and welfare of the residents of New York, lie squarely within the province of the Legislature. *Saratoga County Chamber of Commerce v. Pataki*, 293 A.D.2d 20, 26, 740 N.Y.S.2d 733, 737 (3d Dep't 2002) (holding the Governor did not have authority to enter into a compact with the

Mohawk Tribe as the basic policy decisions underlying the Governor's actions to enter into a compact had not been made by the Legislature) [hereinafter "*Saratoga II*"].

The Legislature has not passed legislation authorizing RGGI or regulations thereunder. Moreover, DEC and NYSERDA's authorizing statutes do not grant power to DEC or NYSERDA to implement a regional cap and trade program, or authorize a taxation program that will raise over $149 million annually at the expense of New York electricity consumers. No matter how laudable the goal of reducing greenhouse gas emissions, only the Legislature has the power to commit New York State to the RGGI Compact.

The RGGI program, as agreed to by the Governor, on the other hand, has usurped the Legislative function by enacting environmental policies and a taxation program that have not been approved by the Legislature. When the executive attempts to make fundamental policy choices not approved by the Legislature— here participation in a regional environmental program, participation in a regional auction of allowances to reduce the amount of greenhouse gases, and the taxation of greenhouse emissions at the expense of New York's energy consumers—the Governor necessarily exceeds his power. *Saratoga III* at 822, 766 N.Y.S.2d at 667. Circumventing legislative approval, the-then Governor entered the RGGI program in the same manner as he entered the Compact at issue in *Saratoga III.* As with the Tribal-State Compact in *Saratoga III*, the Governor's unilateral action in entering the RGGI Agreement usurped the Legislature's role by depriving the Legislature of its policymaking authority.

Moreover, in entering into and implementing the RGGI Compact on putative executive authority alone, the Governor has acted in disregard of his predecessors' consistent history of obtaining Legislative approval for entry into interstate compacts, especially those involving environmental issues. *See. e.g.*, the Atlantic States Marine Fisheries Compact, N.Y.

ENVTL. CONSERV. LAW § 13-0371 (2004); the Delaware River Basin Compact, N.Y. ENVTL. CONSERV. LAW § 21-0701, *et seq.*; the Susquehanna River Basin Compact, N.Y. ENVTL. CONSERV. LAW § 21-1301, *et seq.*; the Interstate Compact to Conserve Oil and Gas, N.Y. ENVTL. CONSERV. LAW § 23-2101; the Northeastern Forest Fire Protection Compact, N.Y. ENVTL. CONSERV. LAW § 9-1123; and the Ohio River Valley Water Sanitation Compact, N.Y. ENVTL. CONSERV. LAW § 21-0301. Each of these compacts involving environmental issues has received the express approval of the New York Legislature.

The failure of the Governor to have obtained legislative approval for the RGGI Compact, at inception or since, is a fundamental flaw that completely negates the authority of the Respondent/Defendant agencies to implement RGGI. Because New York's participation in RGGI stems from an *ultra vires* act of the Governor, the acts of the Respondent/Defendant agencies are of no legal force or effect.

B. The Implementation Of New York's RGGI Program Is *Ultra Vires* With Respect To DEC And NYSERDA As It Exceeds Their Statutory Authority

In implementing RGGI, DEC and NYSERDA have acted in an *ultra vires* manner because the agencies have not been granted such authority by the Legislature.

In New York, agencies are "creatures of the Legislature within the executive branch" and thus, may act only in accordance with the authority granted to them. *Liao v. N.Y. State Banking Dep't*, 74 N.Y.2d 505, 510, 549 N.Y.S.2d 373, 375 (1989). Thus, NYSERDA and DEC "cannot create rules, through [their] own interstitial declaration, that were not contemplated or authorized by the Legislature and thus, in effect, empower themselves to rewrite or add substantially to the administrative charter itself." *Id.* Neither DEC nor NYSERDA has statutory authority to control CO_2 emissions through a cap and trade program, or to consider or regulate the interstate trading of allowances through an auction market.

NYSERDA, a public benefit corporation under Article 8, Title 9 of the New York State Public Authorities Law ("PAL"), was created by the New York Legislature with "specific powers." N.Y. PUB. AUTH. LAW § 1850, *et seq.*; *see also City of Rye v. Metro. Transp. Auth.*, 24 N.Y.2d 627, 635, 249 N.E.2d 429 (N.Y. 1969). Specific powers granted to a public corporation should be strictly construed and powers not stated in the statute should not be implied. *Koch v. Dyson*, 85 A.D.2d 346, 374, 448 N.Y.S.2d 698, 715 (2d Dep't 1982).

As noted in Section II.E above, NYSERDA's mandate is to develop and implement new energy technologies and promote energy conservation. N.Y. PUB. AUTH. LAW § 1854. NYSERDA has the powers to: (1) research, develop and demonstrate new energy technologies; (2) to provide services required for the development and use of new energy technologies; (3) to advise the legislature of recommendation for implementing new energy technologies and energy conservation measures; (4) to coordinate the state's administration of any energy or energy resource programs of the federal government; (5) to advise and assist the governor and the legislature in the development and implementation of state policies relating to energy. *Id.* at § 1855.

The statutes which govern NYSERDA make no reference to any authority for NYSERDA to administer an auction of CO_2 allowances under the RGGI program. Moreover, nothing in NYSERDA's charter suggests that the implementation of the RGGI program is essential to performing the research and policy-related tasks entrusted to NYSERDA by Legislature. *See Koch*, 85 A.D.2d at 374, 448 N.Y.S.2d at 715; *see also Civil Serv. Forum v. N.Y. City Transit Auth.*, 4 A.D.2d 117, 123, 163 N.Y.S.2d 476, 482 (2d Dep't 1957), *aff'd*, 4 N.Y.2d 866, 174 N.Y.S.2d 234 (N.Y. 1958) (holding that NYSERDA has only powers that

expressly conferred to it or by necessary implication but that those powers should not be freely inferred).

Moreover, NYSERDA's governing statutes are devoid of any grant of authority for it to issue licenses of any kind. Under the State Administrative Procedure Act, RGGI's CO_2 allowances are considered licenses or permits. N.Y. A.P.A. LAW §102(4) (defining licenses as "the whole or part of any agency permit, certificate, approval, registration, charter, or similar form of permission required by law"). Under the RGGI program, DEC issues allowances and places them in NYSERDA's account. NYSERDA then forwards the allowances to the auction and through the auction to any purchasers, thus selling the CO_2 allowances as licenses. N.Y. COMP. CODES R. & REGS. tit. 12, § 507.6(a). Licensing cannot be considered an implied power as it is not essential to the purposes for which NYSERDA was created. *Civil Serv. Forum*, 4 A.D.2d at 123, 163 N.Y.S.2d at 482.

In its Response to Public Comments, AR 17, NYSERDA took the position that

> [a]llowances themselves are not permits or licenses under the UPA or SAPA. Rather an allowance is a condition of an operating permit that constitutes a limited authorization to emit up to one ton of CO_2. Under the proposal, each CO_2 budget source must modify its operating permit pursuant to 6 NYCRR Parts 201 and 621 to include all applicable program requirements. . . .Thus, allowances represent a limited authorization to emit CO_2 that regulated sources must obtain as one condition of operation pursuant to an overarching operating permit.

AR 17 at 13.

NYSERDA's sophistry is unavailing. As NYSERDA itself says, an allowance is "a limited authorization" thereby falling within the definition of license. Emitting sources certainly must obtain the requisite allowances as a part of their permitting and approval process, making the allowance a "condition of an operating permit" and "part of any agency permit, certificate, approval, registration, charter or similar form of permission required by law." N.Y.

A.P.A. Law § 102(4). Thus, the allowance is necessarily a license, which NYSERDA is not authorized to transfer, sell or provide to anyone.

Likewise, DEC lacks statutory authority to issue and transfer these allowances to NYSERDA for sale at the allowance auction. Under the RGGI Program, DEC imposes a permitting requirement on electric generating facilities, requiring those facilities to obtain a CO_2 allowance for every ton of CO_2 emitted. N.Y. COMP. CODES R. & REGS. tit. 6, § 242-1.5(c)(1). Indeed, those requirements are expressly to be included in the operating permits the sources must otherwise receive from DEC. *Id.*; AR 17 at 49-50. These allowances are created by DEC and transferred to NYSERDA for sale at auction. Under the DEC Regulations (with very limited exceptions not relevant here), purchasing allowances at auction or through later trades is the only way to obtain an element essential for compliance with a regulatory permit. However, DEC is not authorized by statute to transfer emission permits to NYSERDA for sale, especially where the cost of the permit is based solely on the ability of the allowance purchaser to pay the market price for the allowance and the identity of the permittee is not known to the agency. N.Y. ENVTL. CONSERV. LAW § 70-0107(3)(g).

Moreover, under DEC's authorizing regulations, RGGI's allowances are considered "minor permits," requiring DEC compliance with various mandatory procedures applicable to the issuance of such permits. N.Y. COMP. CODES R. & REGS. tit. 6, § 621.4 (g)(2); N.Y. ENVTL. CONSERV. LAW § 70-0111. The current RGGI scheme, procedurally and substantively, does not meet those requirements.

Lastly, even if the RGGI program is deemed to impose a fee rather than a tax (see Section III.C, *infra*), the current regulations are *ultra vires* because DEC and NYSERDA lack authorization by the Legislature to impose such fees. DEC is not specifically authorized to

engage in autonomous fee-making authority; any fees DEC imposes must be expressly authorized by the Legislature. N.Y. ENVTL. CONSERV. LAW § 72-0201(1)(a) (specifically listing the dollar amounts DEC is authorized to collect). *See also Liao*, 74 N.Y.2d at 511, 549 N.Y.S.2d at 375 (stating that agencies may not establish fees *sua sponte* without the Legislature's express delegation of fee-making authority). Likewise, NYSERDA has no authority to create fees under its operating authority. N.Y. PUB. AUTH. LAW § 1855.

Because the RGGI program lacks any authorization from the State Legislature, the regulations promulgated thereunder represent *ultra vires* actions by DEC and NYSERDA and must be overturned.

C. The RGGI Program, Through The Auction Process, Imposes An Impermissible Tax Not Authorized By The New York Legislature.

Under DEC and NYSERDA regulations implementing RGGI, DEC issues allowances to the NYSERDA, which in turn provides such allowances to the RGGI Authority for sale at an auction in which all the Compact States participate. Once the New York allowances are committed to auction, NYSERDA has no control (or even any direct information) over who has purchased the allowances that were placed into its account. Instead, NYSERDA receives payment in the form of auction proceeds as determined by the sale of allowances at that particular auction's market clearing price.

The effect is a revenue-generation machine created entirely by executive fiat. Emitting sources are required to obtain allowances as part of their permitting requirements by DEC; however, sources may obtain those allowances only at the RGGI auction or by later trades. The cost of the allowances is not set by NYSERDA, nor is it rationally related to the cost of implementing, administering or enforcing a regulatory program to control emissions. AR 205. Rather NYSERDA sells the certificates to any willing purchaser (with whom it does not directly

deal), at a "market clearing price" completely divorced from the regulatory costs of program implementation. AR 17 at 27-28. That sale generates significant revenue—revenue that by DEC's and NYSERDA's own admissions in crafting the program will be expended in the unfettered discretion of NYSERDA.

To date, auction revenues allocable to New York State have already exceeded $87.96 million and are forecast to exceed $149 million this year alone. These revenues will be used at NYSERDA's sole, unfettered discretion with no Legislative authorization or approval. A state program which generates revenues by imposing requirements and demanding that affected facilities pay for certificates at a cost that bears no relationship to the costs of implanting the program has a simple name – it's a tax. *Mobil Oil Corp. v. Town of Huntington*, 380 N.Y.S.2d 466, 475 (Sup. Ct. 1975) (holding that "[w]hen the sums collected through a licensing or regulatory measure exceed the cost of administration, then it can be deemed a revenue act regardless of the label").

In New York, to ensure accountability to the electorate, taxes can be levied only by the State Legislature. N.Y. CONST. art. III, § 1; art. XVI, § 1; *see also Greater Poughkeepsie Library Dist. v. Town of Poughkeepsie*, 81 N.Y.2d 574, 579, 601 N.Y.S.2d 94, 97 (1993) (holding that the taxation power is vested solely in the Legislature). Furthermore, these taxation powers may not be delegated to administrative agencies. *Greater Poughkeepsie*, 81 N.Y.2d at 580, 601 N.Y.S.2d at 97. Moreover, public authorities, such as NYSERDA, are prohibited from levying taxes, although they can exact fees, provided those fees are a "visitation of the costs of special services upon the one who derives a benefit from them." *Phillips v. Town of Clifton Park Water Auth.*, 286 A.D.2d 834, 834, 730 N.Y.S.2d 565, 566 (3d Dep't 2001), quoting *Jewish Reconstructionist Synagogue of N. Shore v. Rosyln Harbor*, 40 N.Y.2d 158, 386 N.Y.S.2d 198

(1976); *see also* N.Y. PUB. AUTH. LAW § 1120-d(20). Where the charges are exacted for revenue purposes or to offset the cost of governmental functions, they are an impermissible and unauthorized tax. *Phillips*, 286 A.D.2d at 835, 730 N.Y.S.2d at 566-67 (quoting *Matter of Torsoe Bros. Constr. Corp. v. Bd. of Trs.*, 49 A.D.2d 461, 465, 375 N.Y.S.2d 612, 617 (2d Dep't 1975)); *see also N.Y. Tel. Co. v. City of Amsterdam*, 200 A.D.2d 315, 317, 613 N.Y.S.2d 993, 995 (3d Dep't 1994); *Orange & Rockland Utils. v. Town of Clarkstown*, 80 A.D.2d 846, 847, 444 N.Y.S.2d 670, 670-71 (2d Dep't 1981).

The Legislature can delegate to agencies the power to collect licensing or regulatory fees with express statutory authorization. *Am. Ass'n of Bioanalysts v. Axelrod*, 106 A.D.2d 53, 56-57, 484 N.Y.S.2d 288, 290 (3d Dep't 1985). Fees are intended to "cover the cost of the regulation" rather than generate substantial revenue. *Health Servs. Med. Corp.*, 175 Misc. 2d at 624, 668 N.Y.S.2d at 1010. Fees cannot be more than "reasonably necessary to cover the costs of issuance, inspection and enforcement." *Id.* Taxes, in contrast, raise money in support of government programs and are generally enacted for revenue purposes. *Id.* at 624, 668 N.Y.S.2d at 1009-10. *See also Am. Sugar Ref. Co. v. Waterfront Comm'n*, 55 N.Y.2d 11, 26-27, 447 N.Y.S.2d 685, 692 (1982).

DEC and NYSERDA have admitted from the inception of the auction concept that the auction process would generate significant revenues and that the purpose of using the auction process was to take the revenue that might otherwise flow to affected facilities and to use that revenue for state purposes, not private purposes. *See, e.g.*, AR 17, 82, 120-121 & 159. According to the regulations, the proceeds will both cover the administrative costs and fund other government programs. In relevant part, the regulations state the funds collected are to be used to:

> promote and implement programs for energy efficiency, renewable or non-carbon emitting technologies, and innovative carbon emissions abatement technologies . . .and for reasonable administrative costs incurred by [NYSERDA] in costs, auction design and support costs and program design and support costs associated with the CO_2 Budget Trading Program, whenever incurred.

N.Y. COMP. CODES R. & REGS. tit. 21, § 507.4(d).

There is not even a pretense in the underlying record that the revenues to be generated bear any relation to the cost of administering and enforcing the allowance program; indeed, the record states that administration and enforcement costs will be capped at 10% of the revenues generated. AR 17 at 171-72. And there is a frank admission that the regulations authorize NYSERDA to spend the revenue to offset the cost of governmental programs, or simply to create new government programs at its whim. AR 7-8. The program was in fact *intentionally* designed to create a pool of money—exceeding the administrative and enforcement cost of the program—to fund other related and unrelated environmental programs. AR 7, 8, 82, & 158-59; N.Y. COMP. CODES R. & REGS. tit. 21, § 507.4(d).

The Legislature created NYSERDA to "accelerate the development and use within the State of new energy technologies" and "foster, sponsor and assist development and demonstration of new energy generation and conservation technology." AR 129 at 3. Being tasked with those goals is not a license to create a massive tax scheme to support them. Without express legislative authorization, NYSERDA has no authority to implement an administrative tax as required by the RGGI proposal and cannot justify this tax under generic authority granted under NYSERDA's authorizing legislation.

The only possible conclusion on the record is that the revenues are a tax, which can only be imposed by the Legislature and not by administrative fiat. Neither DEC nor

NYSERDA are authorized by the Legislature to create a tax that generates annual revenues that exceed administrative costs.

The features of the RGGI program—a mandatory allowance auction, generation of funds beyond just administrative and enforcement costs, and the expressed intention of NYSERDA to use the funds as it sees fit—demonstrate that the RGGI program creates an unlawful administrative tax. Since there is no legislative authorization for such a tax, the RGGI regulations implementing it are illegal and void *ab initio*.

D. Without Prior Congressional Approval, The Ten Northeastern States' Agreement To Regulate Greenhouse Gas Emissions Through A Cap And Trade Allowance Program And Auction Is An Impermissible And Unconstitutional Compact

The Compact Clause of the United States Constitution expressly limits the power of the States to enter into agreements or compacts with each other without the consent of Congress. U.S. CONST. art. I, § 10, cl. 3.[8] The Compact Clause prohibits, absent Congressional approval, agreements or compacts among the States "which may tend to increase and build up the political influence of the contracting states, so as to encroach upon or impair the supremacy of the United States, or interfere with their rightful management of particular subjects placed under their entire control." *Virginia v. Tennessee*, 148 U.S. 503, 517-518 (1893).

In *U.S. Steel Corp v. Multistate Tax Commission*, the U.S. Supreme Court held that if a Compact enhances State power with respect to commerce, then that Compact requires Congressional consent. 434 U.S. 452, 475 (1978). The Court explained that the Compact Clause

[8] The Compact Clause in full reads "No State shall, without the Consent of Congress, lay any duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay." U.S. CONST. art. I, §10, cl. 3. We note that the RGGI Compact States specifically contemplate that Canadian Provinces would be permitted to join the compact, and to participate fully. Upon entry of any Canadian entity into the Compact, it would appear to be an "Agreement or Compact with ...a foreign Power....", and to require renewed Congressional approval. *See* http://www.eoearth.org/article/Climate_leadership_in_northeast_North_America (while RGGI does not currently include any Canadian provinces, Figure 2 shows that Canadian provincial officials have observed RGGI meetings).

applies when two States obtain joint power over interstate commerce that neither could have obtained individually. *Id.* The Compact States' agreement to regulate greenhouse gases through RGGI manifests exactly an exercise of such power.

RGGI, and specifically the joint auction of allowances, enhances the power of the States to regulate interstate commerce beyond that of any single State acting alone. The admitted purpose of RGGI is to enhance the region's economy by augmenting the region's energy security and by retaining energy spending and investments in the region. AR 245 at 2. Such joint action must be approved by Congress pursuant to the Compact Clause.

Moreover, RGGI encroaches upon federal authority to enact and enforce interstate environmental law. Congress has the power to regulate emissions and has authorized the U.S. Environmental Protection Agency ("EPA") to establish interstate emission limits. RGGI's regulations impermissibly encroach on federal jurisdiction in this area.

RGGI also poses a threat to the federal government's exclusive power to regulate interstate commerce. Under the Federal Power Act, Congress has exclusively and completely occupied the area of interstate commerce in electricity, and designated the Federal Energy Regulatory Commission as the exclusive regulatory body. *See Miss. Power & Light Co. v. Miss. ex rel. Moore*, 487 U.S. 354, 371 (1988); *see also Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986). The ability of out-of-state producers who do not have to purchase allowances to sell into the markets of RGGI states creates a problem of "leakage"; any attempt by RGGI to curb this "leakage" will necessarily involve an attempt to regulate interstate commerce in derogation of the federal government's jurisdiction in this area. *See The Compact Clause and the Regional Greenhouse Gas Initiative*, 120 HARV. L. REV. 1958, 1965 (2007); *see*

also Steven Ferrey, *Carbon and the Constitution: State GHG Policies Confront Federal Roadblocks*, PUBLIC UTILITIES FORTNIGHTLY, Apr. 2009, at 42-43.

It is noteworthy that previous interstate agreements to which the State of New York is a member have always been implemented with approval from Congress. *See, e.g.,* New York-New Jersey Port Authority Compact, Pub. L. No. 96-163, 93 Stat. 1242 (1979); Palisades Interstate Park Compact, Pub. Res. 75-65; 50 Stat. 719 (1937), (cited in Caroline N. Broun *et al.*, *The Evolving Use and the Changing Role of Interstate Compacts: A Practitioner's Guide*, 469-71 (ABA Publishing 2006)); Atlantic States Marine Fisheries Compact, Pub. L. No. 77-539, 56 Stat. 267 (1942), as amended by Pub. L. No. 81-721 (1950) (approved by Congress in 1942), *N.Y. v. Gutierrez*, No. 08-CV-2503, 2008 WL 5000493, at *2 (E.D.N.Y. Nov. 20, 2008); Delaware River Basin Compact, Pub. L. No. 87-328, 75 Stat. 688 (1961), as amended by Pub L. No. 98-490 (1984) (approved by Congress in 1961), *New Jersey v. Garcia*, 687 A.2d 804, 807 (Palmyra Mun. Ct. 1996); Susquehanna River Basin Compact, Pub. L. No. 91-575, 84 Stat. 1509 (1970), as amended by Pub. L. No. 99-468 (1986) (approved by Congress in 1970) (cited in Caroline N. Broun *et al.*, *The Evolving Use and the Changing Role of Interstate Compacts: A Practitioner's Guide* 483); Interstate Compact to Conserve Oil and Gas, 79 Pub. Res. 31, 53 Stat. 1071 (1939), renewed Pub. L. No. 86-143, 73 Stat. 290 (1959), renewed Pub. L. No. 88-115, 77 Stat. 145 (1963), renewed Pub. L. No. 90-185, 81 Stat. 560 (1967), renewed Pub. L. No. 94-493 (1976) (approved by Congress in 1939) (cited in Broun at 429-30); Northeastern Forest Fire Protection Compact, Pub. L. No. 81-129, 63 Stat. 271 (1949), as amended by Pub. L. No. 110-79 (2007) (approved by Congress in 1949) (cited in Broun at 466); Ohio River Valley Water

Sanitation Compact, Pub. L. No. 76739, 54 Stat. 752 (approved by Congress in 1940) (cited in Broun at 468).[9]

RGGI is precisely the kind of interstate agreement that requires Congressional approval. The Program creates a regional administrative body empowered to issue regulations and adopt practices to regulate CO_2 emissions in violation of the Compact Clause; these powers are specifically reserved to federal authority. RGGI benefits the Compact States at the expense of all other States and affects a matter of national concern by interfering with federal authority regarding interstate effects of emissions of pollutants and interstate commerce in electricity.

Congress never approved nor was asked to approve RGGI. There has been no federal participation in the negotiation of the program. Furthermore, no federal representatives are involved to monitor its rules and practices. The Compacting States have self-authorized RGGI on their own authority in violation of the Compact Clause.

Since *Virginia*, the U.S. Supreme Court has held that any agreement among the states that impermissibly enlarges political influence over matters of national interest without Congressional consent violates the Compact Clause. *Virginia*, 148 U.S. at 517-518. That is certainly the case here and is yet another reason that the RGGI Compact cannot stand.

E. DEC's Regulations Imposing The Cap And Trade Program Are Arbitrary And Capricious, Imposing A Discriminatory Cost On Indeck.

DEC and NYSERDA have imposed a cap and trade program and implemented that program in a manner that is arbitrary and capricious, in at least four separate ways. First, DEC's and NYSERDA'a abdication of all discretion to the RGGI Working Group has impermissibly flawed the promulgation of the New York RGGI regulations. Second, the RGGI

[9] Additionally, all of these compacts were approved by the New York Legislature before they came into force. *See* discussion in Section III.A, *infra*

regulations, as implemented, are arbitrary and capricious, discriminating against Indeck with no rational basis. Third, the regulations as promulgated constitute an unlawful taking of Indeck's property rights: New York assured Indeck of its right to receive the full avoided costs as qualifying facilities, Indeck relied on those promises, and New York has breached those commitments as a result of the RGGI regulations. Fourth, the PSC has actively worked with DEC and NYSERDA, carefully avoiding making any regulatory decisions and has instead enunciated ad hoc policies unlawfully to the injury of Indeck.

The regulations promulgating the cap and trade program are reviewable under an Article 78 proceeding under the arbitrary and capricious standard. An "[a]rbitrary action is without sound basis in reason and is generally taken without regard to the facts." *Pell v. Bd. of Educ.*, 34 N.Y.2d 222, 231, 356 N.Y.S.2d 833, 839 (N.Y. 1974). The proper standard of review is whether the action of the administrative board "was affected by an error of law or was arbitrary and capricious or an abuse of discretion." *Hawley v. Cuomo*, 46 N.Y.2d 990, 991, 416 N.Y.S.2d 232, 233 (N.Y. 1979) (*quoting* N.Y. C.P.L.R. § 7803). This standard has been further interpreted and clarified to mean "a willful and unreasoning action without consideration of or in disregard of the facts, or a determination without a factual basis." *The Center Square Ass'n, Inc. v. Corning*, 105 Misc. 2d 6, 10, 430 N.Y.S.2d 953, 957 (Sup. Ct. 1980) (citation omitted). As set forth below, DEC acted in an arbitrary and capricious manner and without regard to the facts.

1. DEC's And NYSERDA's Process In Promulgating The Regulations Abdicated Discretion To The RGGI Working Group And Was Thus Arbitrary And Capricious.

In promulgating regulations under the RGGI program, DEC arbitrarily determined the allocation of allowances should be accomplished by auction and in an irrational manner that

imposes costs unrelated to compliance and enforcement. Because the agency fully surrendered its discretion and authority to the RGGI authority, the regulations were improperly promulgated, especially with respect to the auction process and limitation on allocating allowances to QFs in Indeck's position.

In order to adhere to the Model Rule requirements as agreed to by the New York State executive, DEC surrendered its discretion to the interstate group that promulgated the RGGI Model Rule. This is especially true with respect to the auction process and the limitations set on allocating allowances to QF entities. Specifically, by following the Model Rule without meaningful consideration of the impacts of the regulations on New York State generators and consumers, DEC has impermissibly surrendered its discretion. Furthermore, DEC has acted arbitrarily in at least the following respects: (1) the determination to allocate allowances by auction rather than by other means, which imposed costs unrelated to compliance and enforcement; (2) the determination to impose costs on facilities like Indeck Corinth, without a safety valve to assure cost recovery; and (3) the adoption of the RGGI MOU and Model Rules in an impermissible delegation of its authority. By failing to meaningfully consider all the facts during the rulemaking, including the impact of the auction process on the avoided cost definition, DEC acted without "sound basis in reason" and its action was "taken without regard to the facts." *See Pell*, 313 N.E.2d at 325.

DEC and NYSERDA, ordered by the Governor to implement the RGGI program as agreed to by the interstate group , proposed regulations consistent with the Model Rule. Their adherence to the strictures of the Model Rule throughout the comment process shows an inherently flawed consideration of the impact of the regulations on the State of New York. Neither DEC nor NYSERDA, despite ample comments to the contrary, would consider the

impact that the regulations had on Qualifying Facilities subject to long term contracts. Other states, such as Maine, considered this possibility and deviated from the Model Rule by implementing a set-aside program. DEC and NYSERDA, on the other hand, refused to do so in New York, claiming that the hardship provisions of the Model Rule sufficient to solve this problem. The inadequacy of this solution demonstrates DEC's and NYSERDA's failure to consider the full ramifications of the RGGI program as it affects New York.

2. RGGI's Final Regulations Are Arbitrary And Capricious And Unlawfully Discriminatory Against Indeck

RGGI's final regulations impermissibly reduce the value of the Indeck facility and its assets by creating an allowance program that prevents Indeck from recovering its costs. Virtually all other similarly situated facilities and emitting sources are permitted and expected under RGGI to pass on the cost of the allowance to the end consumer.

The RGGI regulations allow for the cost of the allowance program to be passed on to all other customers by all other sources except Indeck and a few other similarly situated facilities, which are locked into a long term Purchase Power Agreements ("PPAs"). Since DEC and NSYERDA refused to consider this regulatory outcome given PSC's policies, the regulations as promulgated offer no "safety valve" by which to allow generators like Indeck to recover the cost of allowances. Instead, RGGI requires Indeck to incur the allowance cost without the ability to pass on those avoided costs—an opportunity afforded to all other emitting sources.

Thus, New York State has intentionally treated Indeck differently than other emitting sources with no rational basis for doing so. The U.S. Supreme Court prohibited this type of discrimination when it extended equal protection to a "class of one" where the individual was intentionally treated differently from other similar situated individuals and that treatment was

irrational. *Village of Willowbrook v. Olech*, 528 U.S. 562, 564 (2000). In *Olech*, the Court held that where a township created regulations that adversely impacted one individual from other similar individuals, the township must have a rational basis for doing so. *Id.* at 563. The township, in this case, imposing an easement requirement of thirty-three feet rather than the standard fifteen feet on one permit applicant, was "irrational and wholly arbitrary." *Id.*

Furthermore, the implementation of RGGI as currently structured prevents Indeck and other similarly-situated QFs from being compensated at a rate equal to their counterparties' avoided cost, in contravention of the policies enunciated in Public Utility Regulatory Policies Act ("PURPA"). Therefore, RGGI fails to provide the requisite encouragement to cogeneration facilities as required by federal law. *See Consolidated Edison Company of New York, Inc. v. Public Service Commission,* 63 N.Y.2d 424, 437 n.8, 472 N.E.2d 981, 483 N.Y.S.2d 153 (N.Y. 1984) (citing 45 Fed. Reg. 122211-12222, § 292.304).

PURPA was enacted in 1978 in response to disruptions in energy markets. *See* 16 U.S.C. § 824a-3, *et seq*; *see also FERC v. Mississippi*, 456 U.S. 742, 745 (1982). Section 210 of PURPA encourages the development of cogeneration facilities and small power production plants (collectively, QFs) as a means of reducing the demand for fossil fuels. *Occidental Chemical Corp. v. Louisiana Public Service Commission*, 494 F. Supp. 2d 401, 406 (M.D. La. 2007). One component of that policy was Congress' direction to FERC to promulgate rules requiring traditional facilities to purchase and sell electricity to QFs. *FERC v. Mississippi*, 456 U.S. at 750-51. Section 210(b) of PURPA dictates that utilities must purchase electricity from QFs at the utility's "avoided cost." Avoided cost is defined by FERC as "the incremental costs to an electric utility of electric energy or capacity or both, which but for the purchase from the

qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101(b)(6).

Pursuant to Section 210(f), states are required to implement PURPA via the relevant state agency having regulatory authority over electric utilities. 16 U.S.C. § 824a-3(f). Under current federal jurisprudence, a state's failure "to ensure that utilities pay QFs for energy at a rate equal to the utilities full avoided cost 'is a failure to comply with a regulation implementing' PURPA." *Occidental*, 494 F. Supp. 2d at 410 (quoting *Conn. Value Elect. Co. v. FERC*, 208 F.3d 1037, 1043 (D.C. Cir. 1997)); *see also New York State Elec. Gas Corp. v. FERC*, 117 F.3d 1473, 1476 (D.C. Cir. 1997).

In *Consolidated Edison,* the Court of Appeals confirmed, among other things, that in the event a QF's avoided cost is above a regulatory prescribed minimum rate (due to price of fuel or other costs of producing energy), federal law would require that the avoided-cost be paid to a QF. *See Consolidated Edison*, 63 N.Y.2d at 438 n.9 & n.10 (*citing FERC Preamble,* 45 Fed. Reg. 12221). The court stated:

> This Commission has set the rate for purchases at a level which it believes appropriate to encourage cogeneration and small power production, as required by section 210 of PURPA. While the rules prescribed under section 210 of PURPA are subject to the statutory parameters, the States are free, under their own authority, to enact laws or regulations providing for rates which would result in even greater encouragement of these technologies. However, State laws or regulations which would provide rates lower than the federal standards would fail to provide the requisite encouragement to these technologies and must yield to Federal Law.

Consolidated Edison, 63 N.Y.2d at 438 n.9

In *Freehold Cogeneration Assocs., v. Board of Regulatory Commissioners of the State of New Jersey,* the New Jersey state regulatory board approved a purchase power agreement between and QF and an electrical utility. 44 F.3d 1178, 1183 (3rd Cir. 1995). The

regulatory board later initiated proceedings to review the agreement, intending to revoke approval of the terms of the agreement. The court held the QF immune from the attempted revocation. *Id.* at 1191-92. "The regulations do not disturb the authority of state regulatory agencies to review contracts for purchases so long as those regulations are consistent with the terms, policies and practices of sections 210 and 201 of PURPA and FERC's implementing regulations. If the authority or its exercise is in conflict . . . the State must yield to the Federal requirements." *Id.* at 1192 (internal citations omitted).

Moreover, in *Independent Energy Producers v. California Public Utility Commission*, the California Court of Appeals concluded that the states have no role for setting QF standards or determining QF status. 36 F.3d 848 (9th Cir. 1994). As such, it held that a California state regulation, which suspended payment of rates and substituted a lower rate to a QF specified in the QF's contract with the electric utility, was an impermissible preemption of PURPA by the state regulatory body. *Id.* at 854-55. Moreover, the court held that for reasons of policy, uniformity with respect to treatment of QFs is required:

> As a policy matter, a uniform federal decision maker is necessary for those cases in which the Commission waives the operating and efficiency standards for QF determinations and certifies the facility because it is in the public interest. *See* 18 C.F.R. § 292.205(c). QFs certified in this manner by definition do not meet federal efficiency standards. In a system with dual federal and state enforcement of efficiency standards, however, a state could decide that a QF certified under this waiver provision is not in compliance with efficiency standards and impose sanctions.

Id. at 855.

RGGI currently violates both the general policy of uniformity in treatment of QFs, and the specific policy under PURPA that requires that QFs be paid the avoided cost of the output purchased from them. RGGI increases the cost of producing energy for those entities from whom Con Edison, Indeck's counterparty, would have to purchase power in the absence of

its long-term contract with Indeck. Any such output would, by definition, reflect the cost of the allowances that any other producer would have to purchase. Thus the "avoided cost" that PURPA requires to be paid to QFs necessarily includes the cost of the allowances required under RGGI.

3. Commitments By New York State Government, Inducing Indeck's Reliance, Have Been Breached By The RGGI Regulations At Indeck's Substantial And Ongoing Injury With No Rational Basis

As a result of the RGGI regulations and the specific terms of its power sale agreement that PSC refuses to amend, Indeck has been impermissibly adversely affected in violation of the government's earlier regulation and promise. *See U.S. v. Winstar*, 518 U.S. 839, 883 (1996). In *Winstar*, the U.S. Supreme Court held the Due Process Clause prohibited the U.S. government from reneging on a promise to apply special accounting treatment benefiting acquirers of failing thrift institutions. *Id.* at 839.

Likewise, in this case, the New York executive branch has reneged on promises made under PURPA and through the PSC, to assure QFs would recover full avoided cost payment for power pursuant to the PURPA and FERC regulations promulgated thereunder. The long-term Power Purchase Agreement contemplates that the power purchaser will buy electrical energy at a set price approved by the PSC. Pet. at ¶¶ 24-29. Pursuant to PURPA and FERC regulations promulgated thereunder, the contract price is a proxy for "avoided cost" for that power. *Id.* In contracting initially for the sale of its power, Indeck specifically relied on the assurances by the PSC that the contract reflected the relevant circumstances and that if those circumstances changed, the contract would be modified. *Id.* Many contracts with reopener clauses, which allow the parties to reopen the contract should the governmental regulations (or other exigent circumstances) change, but such clauses were generally disapproved of by the PSC

in the late 1980s and early 1990s as unnecessary, because the PSC retained discretion. As a result, Indeck understood that any reopener clause in the PPA would be disapproved by the PSC and instead, relied on PSC's assurances that Indeck would receive a price that properly reflected avoided cost.

4. The PSC's Ad Hoc Policies And Failure To Take Action In Light Of Indeck's Inability To Pass On The Full Avoided Cost Are Unlawful And Discriminatory Actions

The RGGI program imposes cost on all affected sources of CO_2, but irrationally discriminates against Indeck by foreclosing it from any opportunity to recover the allowance cost. The distinction has no rational basis—under RGGI's general program analysis, the sources pay for allowances at a market determined price, thus specifically assuring that they internalize the costs and price the full value (cost and otherwise) associated with emitting CO_2. Purchasers of power then pay a rate reflecting that fully internalized cost, so that conservation and alternative sources of power are properly priced in relation to each other. Indeck, however, is specifically prevented from reflecting the costs into its pricing.

Furthermore, this situation, which is known to the Defendants, undermines the design and purpose of the auction process. The utility purchaser of power from Indeck, freed from internalizing the cost of allowances since Indeck cannot pass on that cost, obscures the price signaling effect intended by the auction design. Because the power purchaser never sees the cost of allowances related to Indeck's power, there is no basis on which the pricing will reflect the costs of the allowances, and it is able to provide lower cost electric energy, and thus obscuring the price signals to the market. That incorrect price signal not only interferes with proper decisions by consumers, but causes the Indeck facility to be dispatched more (*i.e.*, to be called on more often to produce more power than would otherwise be the case)—causing its

emissions to rise and Indeck's deadweight loss from purchase of allowances to increase. The price signal excluding the cost of allowances also distorts downstream price signals, causing purchasers to consume more power and undercutting RGGI's goal to incentive conservation of power resources. DEC and NYSERDA's failure to acknowledge and address this issue, and their choice instead to simply adopt the RGGI MOU and Model Rule wholesale, demonstrates the arbitrariness and capriciousness of the New York's RGGI regulations.

By imposing the cost but barring recovery, the RGGI regulators irrationally priced specific sources of power, discriminated against the certain owners of generating facilities, and violated PURPA's directives. Such an irrational regulatory scheme, involving specific discriminatory decisions, violates due process and equal protection. And by failing to meaningfully consider all the facts during the rulemaking, including the impact of the auction process on the avoided cost definition, DEC acted without "sound basis in reason" and its actions were "taken without regard to the facts." *See Pell*, 34 N.Y.2d at 231, 356 N.Y.S.2d at 839.

F. The Implementation Of RGGI Prevents Indeck And Other QFs Subject To Long Term Contracts From Receiving Their Full Avoided Cost In Contravention Of PURPA

PSC, not through its own regulatory action, but through other communications with DEC, fostered and abetted a discriminatory implementation of the RGGI program, resulting in a violation of PURPA. PSC aided and fostered certain aspects of RGGI, although not in this instance taking a regulatory action itself, which resulted in (1) a program that discourages development of cogeneration facilities in contravention of PURPA and N.Y. Pub. Serv. Law §66-c, and (2) development of a new rate for the purchase of electricity that exclusively discriminates against QFs subject to long-term power contracts.

Furthermore, PURPA directs that regulatory rates established by FERC for purchases by electric utilities be (1) just and reasonable to the electric consumers of the utility, (2) in the public interest, and (3) not discriminatory against qualifying cogenerators or small power producers. *See Consolidated Edison*, 63 N.Y.2d at 425 (citing 16 U.S.C. § 824a-3(b)). The current RGGI program disregards those Federal mandates, rendering DEC and NYSERDA's promulgation of these regulations arbitrary and capricious.

As directed by PURPA, the New York State Legislature enacted New York Public Service Law § 66-c, which requires utilities to enter into long-term contracts for the purchase of electricity from alterative energy sources including cogeneration facilities. Section 66-c also granted PSC authority to oversee the contracting process and set the purchase rate for long-term power contracts. *See New York State Electric & Gas Corp. v. Saranac Power Partners, L.P.*, 117 F. Supp. 2d 211, 216-17 (N.D.N.Y. 2000) (referencing N.Y. PUB. SERV. LAW § 66-c). The declaration of intent in Section 66-c states, "the policy of this state that it is in the public interest to encourage, at rates just and reasonable to electric and steam corporation ratepayers, the development of alternate energy production facilities, co-generation facilities and small hydro facilities in order to conserve our finite and expensive energy resources." N.Y. PUB. SERV. LAW § 66-c.

The RGGI program fails to comply, or even to fully consider, the rate setting tenets of PURPA. PSC's failure to ensure that Indeck receives its full avoided cost not only evidences the fact that RGGI does not encourage development of QFs by offering the full avoided cost for energy QFs produce, but distorts proper utility dispatch and planning. By virtue of the PSC-directed long-term fixed-price contract between Indeck and its purchaser and by fostering the exclusion of allowance costs form the pricing of power, the PSC pushes the utility

purchaser to purchase increasing amounts of energy from Indeck at its existing rate (a cost that does not reflect the price of allowances). The resulting lower apparent cost to consumers of power destroys the very incentive to reduce consumption and seek out alternative "green" sources of power that the auctioning of allowances was meant to foster. PSC's recommendations, as a result, arbitrarily and improperly interfere with the fundamental design of the RGGI program, with no apparent rationale. Indeed, because the PSC has not formally acted, held any proceeding, or even gone on record with its views, it has been able to interfere with the RGGI program in a manner which seeks to avoid scrutiny and review.

IV. CONCLUSION

The RGGI Regulations have no proper foundation in New York law. They rest on the Governor's improper and unlawful decision to enter into the RGGI MOU without approval of the State Legislature, and his decision to proceed by executive fiat rather than proper statutory support to implement the program. In entering into an interstate compact, the Compact States have breached the federal Constitution, and seek to heighten their authority and role over interstate commerce and even foreign affairs, in violation of the Compact Clause.

In adopting and implementing the Model Rule, DEC and NYSERDA acted without statutory authorization and in excess of their lawful authority, and created a burdensome and improper tax. NYSERDA intends to spend the general revenue raised by the tax with no guidance or control, much less oversight, from the State Legislature, in violation of the absolute requirement that state funds be spent only by proper appropriation. DEC's and NYSERDA's actions in adopting the rules were arbitrary, capricious and unlawfully discriminatory. The actions have injured Indeck, and breached its rights. PSC aided and abetted their improper

actions, and has itself created arrangements that violate federal policies and will interfere with the fundamental designs of RGGI itself.

For all these reasons, RGGI as adopted and implemented in New York must be overturned. By their actions, the Respondent Defendants have turned pursuit of a laudable goal into a breach of fundamental constitutional requirements, usurped the lawful authority of the State Legislature, and perversely twisted the logic of the RGGI program into a device that injures Indeck. The actions of the Respondents-Defendants cannot be permitted to stand.

Dated: April 24, 2009

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EXHIBIT A

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August 19, 2008

By Overnight Delivery
The Honorable David A. Paterson
Executive Chamber
State Capitol
Albany, NY 12224

Re: Proposed 6 NYCRR Part 242 – CO_2 Budget Trading Program

Dear Governor Paterson:

Indeck-Corinth Limited Partnership ("Indeck") is deeply concerned with the August 11, 2008 approval by the New York State Environmental Board of the New York State Department of Environmental Conservation's ("Department") CO_2 Budget Trading Program Rule (the " Rule") set forth in 6 NYCRR Part 242. Notice of the proposed Rule was published in the May 7, 2008 edition of the New York State Register.

Indeck, one of the most efficient and cleanest burning generation facilities, has a long term power purchase agreement ("PPA") with Con Edison, executed in the 1980's, that does not provide a cost recovery mechanism for any incremental Rule costs. After 2 years of discussion with representatives of the Department and the Public Service Commission and other RGGI Rule stakeholders, the Department has provided Indeck and other affected contract generators a Rule set-aside account of 1.5 million allowances subject to a financial hardship demonstration. However, as discussed below, the allowances are short in quantity and near impossible to access through the financial hardship demonstration.

1. **Financial Hardship – 242-5.3(d)(3)**

While certain revisions were made in the financial hardship portion of the Rule, the language that remains is extremely restrictive, and in Indeck's view, a demonstration of hardship would only be acceptable to the Department under the Rule criteria if a generator were at the brink of a bankruptcy filing. This would be enormously unfair to a facility that is one of the cleanest burning power plants on the NYISO grid.

Under the Regional Greenhouse Gas Initiative ("RGGI"), the cost of implementation was to be borne largely by the consumer in the form of higher electric rates. The Department has indicated that the cost of carbon emissions are to be passed through by the generators to the end user, thereby resulting in electric price signals that encourage consumers to conserve electricity or to find a more efficient means to heat and power their

homes/facilities. Efficient and clean burning power generating facilities like Indeck's, which have long term contracts without a pass through mechanism for RGGI costs, are already in a position of hardship, as they are penalized under the Rule when compared to other generators who have the opportunity to pass these costs to consumers. Indeck, with its long term contract dating back to the late 1980's, estimates that, except for the cost of fuel, RGGI costs will be the single largest expense ($2.75 million annually when using the current 2009 futures contract for CO2 allowance price of $5.5), all of which will be totally unrecoverable in the market. Indeck should not be expected to take on such a financial burden. This result is clearly the opposite of what was intended by the RGGI policy.

2. **Increase the Number of Allowances in the Set Aside Account**

As was made clear in a March 12, 2008 letter to the Department from Indeck and four other generators (Calpine Corporation, Brooklyn Navy Yard Cogeneration Partners, L.P., Selkirk Cogen Partners, L.P., SUEZ Energy Generation NA, LLC) with long term contracts without a cost recovery mechanism, the 1.5 million allowances proposed for the set aside account are insufficient. In response to requests from long term contracted generators on this matter, the Department has refused relief in the form of 1) increasing the number of allowances in the set-aside account to match the requirement of the qualified long term contracted generators (approximately 3.5 million), or 2) adding a mechanism to the Rule to permit the Department to allocate more allowances to match the need of all qualifying long term contract applicants on an annual basis or 3) providing a means for generators who need additional allowances to purchase them at a fixed and reasonable price per allowance.

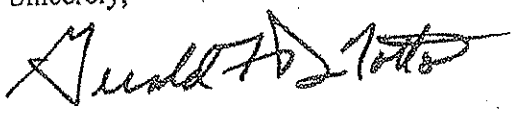
The allocation methodology unfairly penalizes this small group of generators with long term contracts, exactly the type of contracts that New York State has indicated that it desires to encourage, even though the long term contract issue for generators is only temporary in nature. Among the five generators who submitted the March 12, 2008 comments, the number of set-aside allowances needed after 10 years will decrease by 60% based on the expiration dates of their contracts. None will be needed by 2036.

Governor Paterson, clearly there is a need for a more just and reasoned approach to the way the Rule will expose long term contracted generation in New York to the high cost of CO2 allowances anticipated during the RGGI auction process. Indeck has participated at all levels open to stakeholder input prior to Rule implementation and will continue on that path. However, we are concerned that at the same time that the Con Edison rate filing is expected to achieve the recovery of all RGGI costs from their rate base, the future direction for Indeck under the Rule is inevitably toward a bankruptcy filing. This is both unfair and unwise, but is not without solution, as noted above. We ask, therefore, that you provide the leadership required to balance the energy and environmental requirements of a successful Rule by redefining both of the financial hardship and allowance account provisions of the Rule in favor of a more reasoned solution. In the

eyes of Indeck, the current Rule as written, intended or not, provides no less than a Department-driven mechanism to break the Indeck PPA with Con Edison at a time prior to its formally established termination date. That action by the Department may be subject to legal dispute in the near future.

Thank you for your time and consideration.

Sincerely,



Gerald F. DeNotto
President
Indeck-Corinth Limited Partnership
600 N. Buffalo Grove Road
Suite 300
Buffalo Grove, IL 60089

cc:

Ms. Judith Enck, Deputy Secretary for Environment
Mr. Paul DeCotis, Deputy Secretary for Energy
Mr. Peter M. Iwanowicz
Patricia Mastrianni, Esq.
Members of the NY State Senate and Assembly Energy Committees
Members of the NY State Public Service Commission

EXHIBIT B

Porterfield, Latoya

From: Morgan Costello [Morgan.Costello@oag.state.ny.us]
Sent: Tuesday, April 21, 2009 1:31 PM
To: Freeman, David
Cc: Sean Mullany; Michael Myers
Subject: Indeck Corinth v. Paterson et al.--Responses to Indeck's Proposed Record Additions

Attachments: Response to Indeck Additions to Record.DOC

Response to Indeck Additions t...

Dave:

Pursuant to the agreement of the parties in emails exchanged on April 3, 2009, attached are the combined responses of Respondents to Indeck's proposed additions to the Combined Administrative Record. For ease of reference, I took the list you prepared and numbered the documents.

Respondents object to inclusion of the documents that appear in red on the attached list. More specifically, Respondents object to items 3, 4, 6, 13, & 17 as irrelevant: 3, 4, & 6 because they were not before any of the Respondents during the rulemaking process, and 13 & 17 because Indeck is not challenging any actual regulatory decision made by PSC as part of the rulemakings.

Respondents object to items 7, 10, 12, 14, 15, 16, 20, 21(except attachments), & 22 because they are already in the record.

Items 12 & 15 were not on your list, but were included in the package of documents that you sent so I added them to the list. However, it turns out that they are already in the record anyway.

Respondents will add items 1, 2, 5, 8, 9, 11, 18, 19, 23, 24 & 25 to the record. Please advise at to whether you would like the attachments to item 21 added.

Please let either me or Sean know if you have any questions or would like to discuss this further.

Sincerely,
Morgan Costello

Morgan A. Costello
Assistant Attorney General
NYS Office of the Attorney General
Environmental Protection Bureau
The Capitol
Albany, NY 12224-0341
(518) 473-5843
(518) 473-2534 (FAX)
morgan.costello@oag.state.ny.us

Indeck Corinth, L.P. v. David A. Paterson, et al., **Index No. 2009 369**

Documents to be Added to the Administrative Record

1. March 9, 2009 – Title V Air Permit Issued for the Indeck Corinth Energy Center Facility.
2. September 5, 2008 – Letter to David A. Paterson from Gerald F. DeNotto.
3. September 2, 2008 – Letter to Joseph Oates from Gerald F. DeNotto.

4. August 22, 2008 – E-mail to NYS Senate and Assembly Energy Committees from John Hare.

5. August 19, 2008 – Letter to David A. Paterson from Gerald F. DeNotto.

6. July 14, 2008 – Letter to NYS Senator and Assemblypersons from John E. Hare.

7. June 23, 2008 – Letter to Michael P. Sheehan from Michael D. Ferguson.[Same as TAB 55]

8. June 9, 2008 – Remarks of Indeck Corinth, L.P. at Public Hearing for NYS CO2 Budget Trading Program.

9. March 12, 2008 – Letter to Peter M. Iwanowicz from Christopher L. Trabold and Michael D. Ferguson.

10. December 21, 2007 – Letter to Michael P. Sheehan from Christopher L. Trabold and Michael D. Ferguson.[Same as TAB 89]

11. December 17, 2007 – Letter to Peter M. Iwanowicz from Virginia C. Robbins.

12. December 13, 2007 – Remarks of Indeck Corinth, L.P. at Public Hearning of NYS CO2 Budget Trading Program. [Same as contained in TAB 86]

13. December 11, 2007 – Presentation to Robert Curry by Indeck Energy Services, Inc.

14. November 15, 2007 – Letter to RGGI Staff Working Group from Kevin M. Lang. [Same as TAB 198]
15. November 15, 2007 – IPPNY Phase II Auction Report Comments [Same as TAB 197, except cover e-mail]

16. June 15, 2007 – Comments of the Northeast Suppliers on the Auction Design Phase I Research Report. [Same as TAB 204]
17. June 13, 2007 – Presentation to New York State Public Service Commission from Brooklyn Navy Yard Cogeneration Partners, L.P.
18. May 23, 2007 – Letter to Patricia J. Mastrianni from Virginia C. Robbins.

19. May 17, 2007 – Comments of the Northeast Suppliers on the March 14, 2007 Initial Report of the RGGI Emissions Leakage Multi-State Staff Working Group.

20. March 13, 2007 – Letter to NY RGGI List Serve from Doreen U. Saia. [Same as TAB 104]

21. March 13, 2007 – Comments of the Independent Power Producers of New York submitted to the New York State Department of Environmental Conservation by Gavin J. Donohue. [Same as TAB 105—except attachments]

22. March 13, 2007 – Letter to Carl Johnson from Christopher L. Trabold and Michael D. Ferguson. [Same as TAB 100]

23. March 8, 2007 – Letter to Eliot Spitzer from Randall Wolken, Robert A. Mullane, Dennis O'Donnell, John Ragan, Jacob J. Worenklein, Robert M. Loughney, Peter Norgeot, Gerald F. DeNotto and Frank Cassidy.

24. August 17, 1993 – Power Purchase Agreements and amendments between Consolidated Edison and Indeck Energy Services.

25. July 5, 1990 – Letter to William A. Harkins from John J. Kelliher approving Power Purchase Agreements.

Porterfield, Latoya

From: Freeman, David
Sent: Friday, April 17, 2009 1:32 PM
To: 'Morgan Costello'; 'Sean Mullany'
Cc: Patrizia, Charles A.
Subject: Indeck Corinth, L.P. v. Paterson, et al.--Proposed Additions to the Administrative Record
Attachments: Indeck -- Additions to Record(83427743_1).DOC

Morgan and Sean,

Attached, in accordance with our exchange of emails on April 3 and 7, 2009, is an index identifying the documents that Indeck is initially proposing be added to the Administrative Record in this matter. (Indeck's final nominations are due on May 8, 2009.) Hard copies of these documents will be sent out today under separate cover to each of you for Monday delivery; they are also being scanned for electronic transmission to you later this afternoon.

Please feel free to call me if you have any questions or wish to discuss.

Sincerely,

David J. Freeman

David J. Freeman, Esq. | Paul, Hastings, Janofsky & Walker LLP | 75 East 55th Street, New York, NY 10022 | direct: 212 318 6555 | main: 212 318 6000 | direct fax: 212 230 7638 | davidfreeman@paulhastings.com | www.paulhastings.com

Indeck Corinth, L.P. v. David A. Paterson, et al., **Index No. 2009 369**

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF SARATOGA

INDECK CORINTH, L.P.

Petitioner/Plaintiff,

- against -

DAVID A. PATERSON, as Governor, NEW YORK STATE DEPARTMENT OF ENVIRONMENTAL CONSERVATION, NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY, and NEW YORK STATE PUBLIC SERVICE COMMISSION

Respondents/Defendants.

Index No: 2009-369

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
) ss:
COUNTY OF NEW YORK)

Frank N. Dagostino, being duly sworn, deposes and says:

I am not a party to this action, am over 18 years of age, and reside in Jersey City, New Jersey. On the 24th day of April 2009, I served the annexed PETITIONER/PLAINTIFF'S MEMORANDUM OF POINTS AND AUTHORITIES upon the following counsel's by enclosing true and correct copies thereof in a securely sealed and postpaid USPS OVERNIGHT EXPRESS MAIL envelope and depositing same in an official depository maintained by the United States Postal Service as addressed below:

MORGAN COSTELLO, ESQ.
N.Y.S.OFFICE OF THE
ATTORNEY GENERAL
The Capitol
Environmental Protection Bureau
Albany, NY 12224

David Paterson, Governor
NYS Capitol Building
Albany, NY 12207

SEAN MULLANY, ESQ.
STATE OF NEW YORK DEPARTMENT
OF PUBLIC SERVICE
Three Empire State
Albany, NY 12223

the address designated by them for this purpose.

Frank N. Dagostino

Sworn before me this
24th day of April, 2009

Notary Public

JOHN HIRTLE
Notary Public, State of New York
No. 01HI6181813
Qualified in New York County
Commission Expires 02/11/2012