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A Blow To Crypto Miners Disputing Local Energy Rates

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A Washington state federal court recently addressed claims relating to rates that cryptocurrency mining companies pay for electricity in Grant County, Washington. In Blocktree Properties LLC et al. v. Public Utility District No. 2,[i] the U.S. District Court for the Eastern District of Washington rejected all of the miners' legal claims.

The dispute focused on the rate classification that the local municipal electric utility district applied to crypto miners, as explained below. Due to various risks, the miners were assigned to a newly created rate class, referred to as "evolving industries," resulting in a higher electricity rate for the miners. The miners were irate with this decision.

This is just one of a number of issues that miners have faced as a result of their use of vast amounts of energy resources. The high power consumption comes from the computationally intense work that miners perform to validate blockchain transactions and receive cryptocurrency as a reward for successfully doing so. Different validation protocols are used by different cryptocurrency platforms.

One of the most energy-intensive protocols is referred to as "proof-of-work." Transactions are validated a block at a time, with each block representing a set of transactions. The business of mining is competitive. For each block, only one miner is the "winner" and awarded the block reward. By design of the blockchain protocols, the calculations needed to verify a block get more difficult over time and the award is reduced. The increased calculations needed to be awarded a block further drives the need for more energy.

The higher rate classification imposed in Washington is just one of the approaches that various jurisdictions have taken with respect to miners. In some jurisdictions, crypto miners' access to energy has been shut off completely. For example, last fall Kyrgyzstan cut off power to 45 crypto-mining firms for allegedly consuming more electricity (136 megawatts) than three local regions combined. Other jurisdictions have weighed bans or alternative rate structures for miners.

In contrast, some jurisdictions, such as in Canada, have welcomed miners but imposed a tax on crypto-mining businesses. Hydro-Quebec reportedly has an energy surplus equivalent to 100 terawatt hours over 10 years and offers some of the lowest electricity rates in North America.

Background

Electricity rate schedules contain the rates, terms and conditions that apply to particular customer classes. Such classes are typically comprised of users that exhibit common characteristics — e.g., electricity usage, load (i.e., demand) profiles or otherwise — such that they can be effectively grouped together for cost allocation and rate-setting purposes.

At the retail level, common examples of "customer classes" include "residential," "commercial" and "industrial" classes. The customer class that an entity falls into determines which rate schedule (i.e., the rates, terms and conditions) applies to them.

Electric rates in Grant County are set by Public Utility District No. 2 of Grant County. Prior to 2017, the district had 15 distinct rate schedules, with each schedule pertaining to a different customer class.

The district claimed that in the summer of 2017, it experienced a large influx of requests for power service from cryptocurrency miners, who were attracted to the district's low electricity rates. The district alleged that requests from cryptocurrency miners in 2017 totaled 1,500 megawatts of new load, more than twice the district's average load of 600 MW.

The plaintiffs disputed the "influx" of service requests from cryptocurrency miners, arguing that the district inflated this number and did not take appropriate measures to ascertain a realistic estimate of cryptocurrency miners interested in Grant County.

Regardless of the actual number of cryptocurrency mining companies interested in Grant County, the district analyzed how the district could satisfy the new demand, primarily from cryptocurrency miners, while simultaneously servicing existing customers reliably. After public hearings, it developed a new rate schedule, entitled "RS 17," and a new customer class known as the "evolving industries" class.

To decide if an industry falls into the evolving industries class, the district used a test focused on certain risk factors presented by the industry in question. These risks are:

- Regulatory risk — risk of detrimental changes to regulation with the potential to render the industry inviable within a foreseeable time horizon;
- Business risk — potential for cessation or significant reduction of service due to a concentration of business risk in an evolving or unproven industry or in the value of the customer's primary output; and
- Concentration risk — potential for significant load concentration within the district's service territory resulting in a meaningful aggregate impact and corresponding future risk to the district's revenue stream. Evaluation would begin to occur when industry concentration of existing and service request queue customer loads exceeds 5% of the district's total load.

The district argued that these risks are significant for purposes of setting rates, in part, because if an industry requiring a large percentage of the district's power fails, numerous costs related to infrastructure or contracts with other power companies that existed solely to service that industry will be passed on to the remaining customers in the district.

For example, as retail load increases, the district is obligated to purchase additional energy permanently to satisfy that load. That increased commitment to purchase power remains even if evolving industries' customers leave the district's power system, which could result in the district holding surplus power that is no longer necessary to meet its service obligations. Thus, to the extent that the district's sale of this surplus results in a loss, such losses would be borne by remaining customers on the system.

Additionally, the district reasoned that the expansion of the evolving industries class, which by definition requires a relatively large percentage of the district's power, likely will necessitate the development of additional infrastructure. Thus, if an evolving industry customer relocated to another district or failed, the remaining customers on the system would be forced to bear the costs of infrastructure upgrades that were, but are no longer, needed to serve that evolving industry customer.

The Lawsuit and Decision

On Dec. 19, 2018, the plaintiffs (which were cryptocurrency-mining entities with operations in Grant County) filed a complaint, challenging the district's new rate schedule under federal and Washington state law.

The plaintiffs alleged nine causes of action against the district, premised on the U.S. and Washington state constitutions, as well as federal and state laws. The plaintiffs' federal claims included allegations that the district violated (1) the commerce clause of the U.S. Constitution, (2) the due process clause of the Fifth and 14th Amendments, and (3) Section 20 of the Federal Power Act,[ii] by creating an unfair and discriminatory rate schedule.

The plaintiffs' state law claims were brought pursuant to Washington rate-making law, the due process clause of the Washington Constitution, and the privileges and immunities clause of the Washington Constitution.

The following is a brief summary of how the court addressed each of these claims.

Substantive Due Process

Because the plaintiffs had not identified a viable property interest protected by substantive due process, they could not demonstrate that they had been deprived of such an interest without due process.

Procedural Due Process

The district's commission has broad discretion to set rates, and the plaintiffs had not demonstrated that they have a legitimate claim of entitlement to a fair and nondiscriminatory rate under Washington law. Thus, no protected property interest existed to support the plaintiffs' procedural due process claim.

Rate-Making as a Legislative Act

The court agreed with the district's argument that setting rates is a legislative act (not a judicial act, as the plaintiffs argued), to which procedural due process does not apply. Thus, even if the plaintiffs could point to a valid property interest, their procedural due process claim failed as a matter of law.

Dormant Commerce Clause

The court found that the dormant commerce clause does not protect an industry's profit margin, structure or even its existence. Rather, it ensures that states and local governments do not enact laws that favor or protect in-state industry by burdening interstate commerce. The plaintiffs had shown no such burden.

Federal Power Act

The plaintiffs argued that Section 20 of the Federal Power Act prevents the district from charging unreasonable, discriminatory and unjust electric rates.

Section 20 of the Federal Power Act states: "When said power or any part thereof shall enter into interstate or foreign commerce the rates charged and the service rendered by any such licensee ... shall be reasonable, nondiscriminatory, and just to the customer and all unreasonable discriminatory and unjust rates or services are prohibited and declared to be unlawful."

The district raised several arguments that they claimed foreclosed the plaintiffs' Federal Power Act claim. The court addressed them as follows:

- Interstate Commerce — The district argued that Section 20 does not apply because the electricity in question did not enter into interstate commerce. The plaintiffs countered that Section 20 applies to the district because theF district holds a federal hydroelectric license and because electricity from that project enters interstate commerce. They argued that once power enters any interstate grid, it immediately becomes interstate power subject to the provisions of Section 20. The court was skeptical of the plaintiffs' argument, noting that the electricity in this case was generated by a local dam and sold to county customers by a local public utility district. However, given the lack of briefing and clear guidance on this point, the court assumed, without finding, that the electricity is interstate, and proceeded with its analysis based on that assumption.

- Retail Sales — The district also argued that Section 20 does not apply to retail electricity sales. Although the court found no cases applying Section 20 to retail sales, the court was hesitant to issue a finding on this point. Instead, the court noted that because its decision does not depend on this point, it would assume for the purposes of its analysis, without finding, that Section 20 applies to retail sales.
- Plaintiffs' Cause of Action Under Section 20 of the Federal Power Act — The district asserted that Section 20 does not create a private cause of action that allows customers to challenge electricity rates. The court noted that the federal statute through which a plaintiff brings its claim must create both a private right of action and a private remedy. The court found that because Section 20 does not provide the plaintiffs with a private right or a private remedy, the plaintiffs had no cause of action under that statute.

Claims Under Title 42 U.S. Code Section 1983

The plaintiffs brought Section 1983 claims against the district's commissioners for the alleged violations of the plaintiffs' constitutional rights. The court found that because the plaintiffs' constitutional and federal law claims failed as a matter of law, the plaintiffs' Section 1983 claims against the commissioners also failed as a matter of law.

State Law Claims

The court dismissed the state law claims, without prejudice, on procedural grounds. Because the court granted summary judgment in favor of the district on the federal claims, the court declined to exercise supplemental jurisdiction over the plaintiffs' remaining state law claims.

Conclusion

This decision is just one example of the interplay between energy companies and blockchain technology, including crypto mining. Moreover, the district's actions (and subsequent litigation success) may provide a framework that other utilities across the country might adopt to handle increased load associated with crypto mining.

A recent report predicted that the share of blockchain technology in the energy sector will grow at a compound annual growth rate of over 50%. Assuming this prediction holds, we will likely see more energy-related blockchain cases.

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[i] Blocktree Properties LLC et al. v. Public Utility District No. 2 of Grant County, Washington, case number 2:18-CV-390-RMP, in the U.S. District Court for the Eastern District of Washington.

[ii] 16 U.S.C. § 813.