After the Court Has Spoken:

Applying Learjet, EPSA, and Hughes to State Interventions in Wholesale Power Markets

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Panel on: The New Order of Federal/State Jurisdiction Over Energy Regulation; Other Recent Developments Affecting State Regulation of Energy

Contents

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I. Introduction

Due to the "inextricably linked" nature of federal and state energy regulation,[2] drawing a clear dividing line between these two jurisdictional spheres has been no easy task for courts or regulators. Especially in the electricity sector, confusion over these boundaries has only increased due to recent state policies to mandate or incent certain types of generation construction or procurement—actions that, although traditionally under state regulatory purview, nonetheless impact federally-regulated wholesale energy and capacity markets.

As if to underscore the importance of, and increasing uncertainty over, where these boundaries lie, the United States Supreme Court ("Court") recently issued no fewer than three decisions in less than a year's time: *Oneok, Inc. v. Learjet, Inc.,* 135 S. Ct. 1591 (2015) *("Learjet"); FERC v. Elec. Power Supply Ass'n,* 136 S. Ct. 760 (2016) ("*EPSA*"); *Hughes v. Talen Energy Mktg., LLC,* 136 S. Ct. 1288 (2016) *("Hughes").* Through these cases—collectively referred to here as the "Three Decisions"—the Court attempted to draw the dividing line between Federal Energy Regulatory Commission ("FERC") and state authority to regulate the U.S. electric and natural gas industries under the Federal Power Act ("FPA") [3] and the Natural Gas Act ("NGA").[4]

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[1] Stuart Caplan is a Partner, and Adrienne Thompson is an Associate, at Troutman Sanders LLP. The views expressed here are solely those of the authors. This Article was presented in conjunction with a panel on state and federal jurisdiction issues attended by Stuart Caplan, FERC Solicitor Robert Solomon, and Connecticut Assistant Attorney General Clare Kindall as part of the Annual Meeting of the New Orleans Chapter of the Energy Bar Association, May 10, 2017. A previous version of this Article, *"The Court has Spoken: The New Order of Federal-State Energy Regulation Following Learjet, EPSA, and Hughes,"* was first delivered at the Energy Bar Association's Annual Meeting on June 7, 2016, where Stuart Caplan moderated a plenary panel concerning the three U.S. Supreme Court cases discussed herein alongside panelists Max Minzner, General Counsel, FERC, Clare Kindall, Assistant Attorney General, Connecticut, and Erin Murphy, Partner, Bancroft PLLC.

[2] *FERC v. Elec. Power Supply Ass'n,* 136 S. Ct. 760, 766 (2016) *("EPSA").*

[3] *Federal Power Act,* 16 U.S.C. §§ 791a, *et seq.*

[4] *Natural Gas Act,* 15 U.S.C. §§ 717, *et seq.*

This Article explores these Three Decisions and presents a framework with which to not only view them but also to initially analyze other jurisdictional challenges under the FPA and NGA. To that end, this Article proceeds in four parts. Part II reviews the FPA and NGA allocation of authority to regulate electric energy and natural gas, which was the focus of the Court in the Three Decisions. A brief description of the two main forms of Federal Preemption follows that discussion. Part III summarizes the Three Decisions, and provides a framework for analyzing and applying them. Part IV explores how the Three Decisions framework could be applied to a set of recently-established Zero-Emission Credit schemes designed to assist financially struggling nuclear energy generators in New York state and Illinois. Part V reviews the FERC and state-court actions that related to these New York and Illinois cases, and briefly describes other recent developments and looming jurisdictional challenges posed by state energy and generator regulation.

Although it remains to be seen whether the perpetually-blurry jurisdictional line between state and federal energy regulation has been clarified following the Court's pronouncements, one thing is clear: these Three Decisions will not only impact future energy regulation, but also project developers, investors, lenders, utilities, consumers and state and Federal regulators for years to come.

II. Legal Framework

This Part briefly summarizes the statutory and constitutional framework for understanding the Three Decisions and for initially analyzing future FPA and NGA jurisdiction challenges. *EPSA* and *Hughes* were both FPA cases, while *Learjet* was a NGA case. At the same time, *Hughes* and *Learjet* involved jurisdiction and federal preemption questions, while *EPSA* was a more straightforward jurisdiction case.

A. The Jurisdictional Divide Under the FPA and NGA

Under the FPA, FERC has jurisdiction over sales for resale of electric energy and transmission of electric energy in interstate commerce.[5] "In interstate commerce" is not a Constitutional Commerce Clause standard. Rather, FPA section 201(c) provides that "in interstate commerce" means that electricity is produced in one state and consumed anywhere outside of the state (in the United States). The Court long ago affirmed FERC's exercise of jurisdiction based on the "co-mingling" of electric energy.[6] Electric energy travels at the speed of light (186,000 miles per second). Once electric energy enters the

[5] 16 U.S.C. § 824.

[6] *Fed. Power Comm'n v. Florida Power & Light Co.*, 404 U.S. 153 (1972).

interstate electric transmission grid it becomes co-mingled with other energy on the grid and then follows the laws of physics without regard to the geographic dividing lines of states or the paths specified in contracts. On this basis, with limited exceptions,[7] FERC has jurisdiction over wholesale sales (sales for resale) and transmission on the interconnected grid. In contrast, part of Texas is electrically isolated from the rest of the interconnected grid, and wholesale transactions and transmission are generally not subject to FERC jurisdiction.[8]

FERC does not have jurisdiction over any other sales of electric energy (comprising retail sales), over generation siting, or over local distribution of electric energy, which includes bundled retail sales of energy and the lower voltage local delivery of energy usually to retail or end-use customers.[9]

Similarly, under the NGA, FERC has jurisdiction over certain wholesale sales of natural gas and over transmission of natural gas in interstate commerce, but not over retail sales or distribution of natural gas.[10] The transport of natural gas is different than the transport of electricity because gas can be transported intrastate, and the NGA reserves this field for state jurisdiction.

Under both the FPA and NGA, FERC has jurisdiction over matters affecting jurisdictional rates and services. The FPA provides:

> All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, *and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable*, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.[11]

Similarly, the NGA provides:

> All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, *and all rules and*

[7] *See* 16 U.S.C. § 824(f).

[8] The Electric Reliability Council of Texas ("ERCOT") refers to the network of interconnected utilities that together cover approximately 75% of the land area in the state of Texas. *See http://www.ercot.com/about/profile/*. ERCOT is generally not subject to FERC jurisdiction. In addition, Alaska and Hawaii are also exempt from significant parts of FERC's jurisdiction because their isolated grids do not allow for *inter-state* commerce.

[9] *See* 16 U.S.C. § 824(b).

[10] 15 U.S.C. § 717(b).

[11] 16 U.S.C. § 824d(a) (emphasis added).

> *regulations affecting or pertaining to such rates or charges*, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.[12]

The Court has held that FERC's jurisdiction under the "affecting" clause (referred to throughout as "Indirect Jurisdiction") is not unbounded. Rather, as the Court held in *EPSA*, it is limited to "rules or practices that '*directly* affect the [wholesale] rate.'"[13]

In making initial jurisdictional determinations, it can be important to identify whether jurisdiction is derived from an explicit statutory grant of regulatory authority over the specific subject matter FERC is regulating ("FERC Direct Jurisdiction"), or whether it derives from the above-quoted FPA and NGA provisions, which give FERC authority to regulate matters "affecting" jurisdictional services or rates ("FERC Affecting Jurisdiction" or "FERC Indirect Jurisdiction"). Of equal importance in this process is to identify whether the subject matter FERC seeks to regulate falls under the FPA and NGA provisions which explicitly preserve the subject matter of the regulation for the states.[14] We refer to each of these clauses in each statute as the "State Savings Clause" and describe them as reserving for the states jurisdiction over specified activities ("State Reserved Jurisdiction").[15] Finally, there are activities which affect matters within State Reserved Jurisdiction and which states sometimes regulate ("State Indirect Jurisdiction"), but the FPA and NGA do not explicitly reference State Indirect Jurisdiction (or "state affecting jurisdiction"). This Article examines the three jurisdictional categories articulated in sections 201, 205 and 206 of the FPA[16] and sections 1, 4 and 5 of the NGA:[17] (1) FERC Direct Jurisdiction; (2) FERC Indirect Jurisdiction; and (3) State Reserved Jurisdiction, as well as the fourth category not explicitly addressed in the statutes—State Indirect Jurisdiction.

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[12] 15 U.S.C. § 717c(a) (emphasis added).

[13] *EPSA*, 136 S. Ct. at 774 (emphasis in original, citations omitted) (explaining that "a non-hyperliteral reading is needed to prevent the statute from assuming near-infinite breadth").

[14] *See* 16 U.S.C. § 824(b)(1) (reserving to the states jurisdiction over "facilities used for the generation of electric energy[,] … facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, [and] … facilities for the transmission of electric energy consumed wholly by the transmitter"); 15 U.S.C. § 717(b) (reserving to the states jurisdiction over the "transportation or sale of natural gas[,] … the local distribution of natural gas [and] the facilities used for such distribution or to the production or gathering of natural gas").

[15] State agencies do not derive jurisdiction from the FPA or NGA. Rather, state agencies derive jurisdiction from state statutes. The FPA and NGA provisions which explicitly recognize state jurisdiction over or prohibit FERC regulation of certain subjects suggest states are free to regulate these subjects without being Federally preempted so long as the states do not regulate matters subject to FERC Direct Jurisdiction.

[16] 16 U.S.C. §§ 824, 824d, 824e.

[17] 15 U.S.C. §§ 717, 717c, 717d.

B. Federal Preemption

When FERC is acting within its jurisdiction to regulate an activity, if a state seeks to regulate the same activity, it becomes necessary to determine whether the state regulation is federally preempted. There are two main forms of Federal Preemption relevant to the issues discussed here.[18] Field Preemption precludes state regulation of subject matter when Congress has fully occupied the field.[19] In contrast, Conflict Preemption permits state regulation of a subject FERC is regulating or over which FERC has jurisdiction, provided the state regulation does not interfere with FERC's regulation of the same subject.[20]

Not all of the appellate decisions in energy cases involving jurisdictional disputes and preemption are clear about the bases of jurisdiction—whether the basis for FERC jurisdiction was direct or indirect and similarly whether the basis for state jurisdiction was direct or indirect. Yet the form of jurisdiction informs the preemption analysis. When the basis for FERC action is the "affecting clause" (FERC Indirect Jurisdiction), the potential for state regulation of the same subject matter may be present, as was the case in *Learjet*.[21]

Similarly, not all of the appellate decisions in energy cases concerning Federal-state regulatory disputes are clear about the basis of preemption—Field Preemption or Conflict Preemption. This Article analyzes the Three Decisions to clarify the methodology for analyzing such disputes.

The following table presents a simple framework for depicting the permutations for resolving Federal-state disputes under the FPA and NGA.

Jurisdiction-Preemption Matrix

	FERC Direct Jurisdiction	FERC Indirect Jurisdiction
State Direct Jurisdiction		
State Indirect Jurisdiction		

[18] There is also Express Preemption, *see, e.g. Learjet*, 135 S. Ct. at 1592, but the only preemption forms typically implicated in the state and federal actions discussed in this Article are Field Preemption and Conflict Preemption.

[19] *See Learjet*, 135 S. Ct. at 1595.

[20] *See id*.

[21] *See id.* at 1594, 1599.

Each of the four empty cells in the "Jurisdiction-Preemption Matrix" can be populated with Field Preemption, Conflict Preemption or No Preemption. We set out to populate the table below, following a brief summary of the Three Decisions.

III. The Supreme Court Trilogy of FERC v. State Cases

A. *Learjet*

The first of the Three Decisions was *Learjet*. FERC regulates certain wholesale sales of natural gas under the NGA. Many wholesale sales were priced based on natural gas price indices. After becoming concerned that some market participants were manipulating the price of natural gas through false or misleading disclosures to index publishers, FERC adopted regulations to prevent manipulation of indexes and related prices.[22]

In three states, large end use customers brought antitrust actions under state law. The claims included damages resulting from alleged unlawful manipulation of indices on which the plaintiffs' retail (end use) natural gas prices were based. Certain defendants moved for summary judgment to dismiss the complaints, arguing that Field Preemption barred the suits based on FERC's regulation of the gas indexing practices which affect wholesale prices of gas. The District Court granted the motions.[23] The U.S. Court of Appeals for the Ninth Circuit reversed because the complaints sought redress for only impacts on retail sales of gas.[24] The Court largely affirmed the Ninth Circuit and held that FERC was not regulating a wholesale sale of gas. Rather, FERC was regulating practices that *affected* wholesale sales of gas as well as retail sales of gas.[25] The state anti-trust lawsuits, however, were "directed at practices *affecting retail* rates—which are 'firmly on the States' side of that [jurisdictional] dividing line.'"[26] Under the circumstances of *Learjet*, the Court found that the lower court should have analyzed the case under Conflict Preemption and remanded on that basis.[27]

Learjet involved matters affecting both FERC-jurisdictional wholesale sales and state-jurisdictional retail sales of natural gas. Accordingly, within the Jurisdiction-

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[22] *See Amendments to Blanket Sales Certificates*, Order No. 644, 2001-2005 FERC Stats. & Regs., Regs. Preambles ¶ 31,153, *reh'g denied*, 107 FERC ¶ 61,174 (2003), *motion to dismiss granted*, *Cinergy Marketing & Trading, L.P. v. FERC*, No. 04-1168, 2006 U.S. App. LEXIS 14193 (D.C. Cir. June 7, 2006), *petition denied*, *Colo. Office of Consumer Counsel v. FERC*, 2007 U.S. App. LEXIS 14825 (D.C. Cir. June 22, 2007).

[23] *See* Order at 4 & 11, *In re Western States Wholesale Natural Gas Antitrust Litigation*, No. 2:03-cv-1431 (D. Nev. July 18, 2011).

[24] *See In re Western States Wholesale Natural Gas Antitrust Litigation,* 715 F. 3d 716, 729-736 (9th Cir. 2013) ("*Western States*").

[25] *See Learjet*, 135 S. Ct. at 1594, 1599.

[26] *Id*. at 1600 (emphasis in original).

[27] *See id.* at 1599.

Preemption Matrix, *Learjet* is a "double Indirect case" in which the Court found Conflict Preemption analysis more appropriately applied. Under Conflict Preemption, state regulation may coexist with FERC regulation of the same subject matter so long as the state regulation does not interfere with FERC regulation.[28]

In his dissent, the late Justice Scalia, with Chief Justice Roberts joining, criticized the majority for deviating from the Court's precedent holding that if FERC regulated a subject within its jurisdiction, the states were precluded from regulating (whether before a state commission or, as in this case, an antitrust court).[29] The dissent goes on to warn that some companies will be subject to regulation or litigation in many states and at FERC, all concerning the same subject matter.[30] Without broader application of Field Preemption, there will be more cases to litigate the question of whether the state regulation conflicts with FERC regulation and is thus conflict preempted.

B. *EPSA*

The second of the Three Decisions was *EPSA*. FERC regulated (and regulates) the rates, terms and conditions by which demand response participates in the Independent System Operator/Regional Transmission Organization ("ISO") markets. FERC required ISOs to pay full locational marginal price for energy for demand response which curtailed load as part of an economic demand response program.[31] In a two to one split, the U.S. Court of Appeals for the D.C. Circuit held that FERC lacked jurisdiction over demand response because it occurs in the retail market.[32] On the same day the court issued its opinion, FirstEnergy Service Company filed a complaint at FERC seeking to remove all provisions within the PJM Interconnection, L.L.C. ("PJM") tariff that permitted demand response to participate in the PJM capacity market.[33] This was no small matter. The PJM Independent Market Monitor estimated that in one year, demand response cleared 10,000 MW of capacity and reduced market-wide capacity costs by $9 billion.[34] Later in

[28] This would ultimately be the determination of the District Court on remand two years later when it rejected the pipeline-defendants' motion to dismiss on Conflict Preemption grounds. The defendants argued that Conflict Preemption applied "insofar as state law makes 'churning' (rapid, high-volume trading activity) unlawful, because …FERC has opined that the practice does not violate the Natural Gas Act or attendant regulations." The District Court relied on well-trod Conflict Preemption ground to reject that contention and the defendants' motion, holding in part that "the fact that federal law permits a given practice does not mean that compliance with federal law is made impossible by stricter state laws." Reorganized FLI, Inc. v. Williams Cos. (In re Western States Wholesale Natural Gas Antitrust Litig.), 2017 U.S. Dist. LEXIS 49435, *203-204 (D. Nev. Mar. 30, 2017).

[29] *See Learjet*, 135 S. Ct. at 1606-08 (Scalia, J., dissenting).

[30] *See id.* at 1608 (Scalia, J., dissenting).

[31] *Demand Response Compensation in Organized Wholesale Energy Markets*, Order No. 745, III FERC Stats. & Regs., Regs. Preambles ¶ 31,322, *order on reh'g and clarification*, Order No. 745-A, 137 FERC ¶ 61,215 (2011), *reh'g denied*, Order No. 745-B, 138 FERC ¶ 61,148 (2012), *vacated and remanded*, *Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216 (D.C. Cir. 2014), *reversed and remanded*, *Elec. Power Supply Ass'n v. FERC*, 136 S. Ct. 760 (2016).

[32] *See Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216, 223 (D.C. Cir. 2014).

[33] Complaint of FirstEnergy Service Company, Docket No. EL14-55-000 (May 23, 2014), as amended on Sept. 22, 2014.

[34] *See* Monitoring Analytics, Analysis of the 2017/2018 RPM Base Residual Auction at 2 and 6 (Oct. 6, 2014),

2014, the New England Power Generators Association filed a complaint seeking similar prohibitions in ISO-New England.[35]

The Court reversed the D.C. Circuit, upholding FERC's jurisdiction over demand response participation in the wholesale energy market.[36] The D.C. Circuit did not present a plain textual analysis of the FPA in the majority opinion. It relied on a generalization of the FPA's State Savings Clause.[37] A plain text interpretation of the FPA might have focused on whether the sale of curtailment service to a demand response aggregator or load serving entity for offering into an ISO market in lieu of supply side energy or capacity constituted a retail sale of electric energy or local distribution (either a bundled retail sale of electricity or the local, lower voltage delivery of energy).

While the Court on review did not go through a detailed statutory textual analysis, it clearly rejected the circuit court holding that demand response was subject to the FPA's State Savings Clause. Interestingly, the D.C. Circuit held that FERC's interpretation of the FPA was not entitled to *Chevron* deference, deference to an agency in interpreting the statute it implements.[38] The majority found that FERC's interpretation was inconsistent with the statute and therefore was not entitled to deference.[39] The Supreme Court, however, found that it did not need to apply *Chevron* deference because FERC's jurisdiction was so clear.[40]

The issue before the Court was whether FERC lacked jurisdiction, not whether the FPA preempted state regulation of demand response. The Court did not reach the preemption issue, but held that FERC may act because the subject of FERC regulation did not fall under the State Savings Clause (what we term State Direct Jurisdiction).

There is no doubt that demand response affects very directly the price of energy and capacity in the wholesale market. At the same time, offers of demand response and curtailment are not sales for resale of electric energy because they involve curtailment of retail (end use) purchases. Consequently, both *Learjet* and *EPSA* appear to involve

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http://www.monitoringanalytics.com/reports/Reports/2014/IMM_Analysis_of_the_2017_2018_RPM_Base_Residual_Auction_20141006.pdf.

[35] Complaint Requesting Fast Track Processing of the New England Power Generators Association, Inc., Docket No. EL15-21-000 (Nov. 14, 2014).

[36] *See EPSA*, 136 S. Ct. at 767.

[37] *See Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216, 221-23.

[38] *See Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-44 (1984). *See also City of Arlington v. FCC,* 133 S. Ct. 1863, 1870-71 (2013).

[39] *See Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216, 224.

[40] *See EPSA*, 136 S. Ct. at 774 n.5 ("Because we think FERC's authority clear, we need not address the Government's alterative contention that FERC's interpretation of the statute is entitled to deference under *Chevron*…." (citations omitted)). Absent in both decisions was a detailed analysis of the legislative history of the FPA. Typically in cases involving statutory construction, parties with opposite positions claim that each mutually exclusive position is consistent with the plain text of the statute. In the alternative, each opposing party then argues that to the extent there is an ambiguity, the legislative history supports only its interpretation of the statute. Ultimately, the Court found the statute clear in support of FERC's jurisdiction, and there was no need to resort the legislative history.

matters affecting both FERC-jurisdictional wholesale sales and state-jurisdictional retail sales of natural gas (*Learjet*) and electricity (*EPSA*). Within the Jurisdiction-Preemption Matrix, *EPSA* appears to be a "double indirect case." If so, then were there a dispute between FERC and state regulation of demand response, it remains to be seen whether Conflict Preemption analysis applies as it did in *Learjet*.

C. *Hughes*

The third of the Three Decisions was *Hughes*. In this case, the Court found that the state of Maryland had crossed the line and regulated the rate or price received for sales for resale of electric capacity in interstate commerce, an area subject to FERC's jurisdiction.[41] Maryland regulators were concerned that new generation was not locating where and when needed in the state. The Maryland Public Service Commission required state-jurisdictional electric distribution companies ("EDCs") to enter into contracts for differences ("CFDs") such that if the PJM capacity clearing price the generator would receive were below the CFD price, each EDC would pay the generator the difference, and if the PJM capacity clearing price were greater than the CFD price, the generator would pay the EDC.[42]

The Court affirmed the findings of the district court and the U.S. Court of Appeals for the Fourth Circuit, holding that the CFDs established by Maryland were preempted.[43] The Court indicated that the holding was limited.[44] In particular, the Court observed that the CFDs included an obligation by the generator to clear the PJM capacity auction so the CFDs effectively set the capacity price for selling wholesale capacity to PJM, the CFDs were obligatory and not necessarily entered into voluntarily by the EDCs; and did not constitute separate sales of capacity and energy which would have been filed with FERC for review.[45]

In *EPSA*, the Court applied a narrow interpretation of what it meant to set rates for retail sales and on that basis found that demand response did not fall under the State Savings Clause and reversed the D.C. Circuit. In contrast, in *Hughes*, the Court applied a broader interpretation of what it meant to set the price for a wholesale sale of electric capacity. The Court could have determined that CFDs are merely hedges and are not setting the price of capacity and energy in the PJM capacity auctions. Had the Court pursued this route, the case would have fallen within the *Learjet*-like double Indirect Jurisdiction category. Instead, *Hughes* is a FERC Direct Jurisdiction/State Direct Jurisdiction case. Without discussing Field Preemption and Conflict Preemption, the Court apparently applied Field Preemption. In discussing the issues the Court did not

[41] *See Hughes*, 136 S. Ct. at 1297.

[42] *See id.* at 1294-96.

[43] *See id.* at 1296.

[44] *See id.* at 1299.

[45] *See id.*

reach, the Court indicated it did not address the Fourth Circuit's alternative finding that the state regulation interfered with the FERC jurisdictional wholesale market, a finding relevant under Conflict Preemption.[46]

D. The FERC-State Jurisdiction Preemption Matrix

Based on the analysis presented above, the Three Decisions can be placed in the FERC-State Jurisdiction Preemption Matrix presented below. The matrix is followed by an explanation of why.

Populated Jurisdiction-Preemption Matrix

	FERC Direct Jurisdiction	FERC Indirect Jurisdiction
State Direct Jurisdiction	*Hughes* - Field Preemption	*EPSA* dicta - No Preemption
State Indirect Jurisdiction		*Learjet* – Conflict Preemption *EPSA*

Learjet is placed in the double Indirect cell, and Conflict Preemption applies. This is beyond question because the Court made it clear that the regulation and creation of gas index publishing was not the regulation of either a wholesale or retail sale of natural gas under FERC or state jurisdiction, respectively. Rather, the Court found that the subject of regulation affected both.[47] Under these circumstances, although the Court affirmed the Ninth Circuit's holding that the state regulation (in the form of antitrust cases) was not Field Preempted, it nonetheless remanded because a Conflict Preemption analysis should have been applied to determine if the state regulation nonetheless interfered with FERC regulation.

EPSA is placed in the double Indirect cell. The Court found: "First, the practices at issue in the Rule—market operators' payments for demand response commitments—directly affect wholesale rates. Second, in addressing those practices, the Commission has not regulated retail rates."[48] The case did not address whether a state rule conflicted with FERC regulation of the wholesale electric market. Instead, the case was decided on jurisdictional grounds. The Court reversed a D.C. Circuit holding that FERC was regulating in an area reserved for the states—setting rates for retail sales of electric energy.[49] Once the Court held that FERC regulation of rates for demand response offered into the wholesale market did not constitute regulating the rates for retail (end use) sales

[46] *See id.* n.12.

[47] *See Learjet*, 135 S. Ct. at 1594 ("The pipelines' behavior affected *both* federally regulated *wholesale* natural-gas prices and nonfederally regulated *retail* natural-gas prices. The question is whether the federal Natural Gas Act pre-empts these lawsuits.") (emphasis in original).

[48] *See EPSA*, 136 S. Ct. at 773.

[49] *See id.* at 773-82.

of electric energy, the foundation of the circuit court decision was removed.

Preemption issues were not before the Court in *EPSA*. If a conflict between state and FERC regulation of demand response arises in the future, then it would appear likely that FERC's jurisdiction over demand response participation in the wholesale market will be upheld so long as FERC does not cross the line of regulating the retail sale of electricity or its price (more narrowly construed than the D.C. Circuit construed this sphere of activity). *Learjet*, however, suggests that states may also regulate demand response, subject to Conflict Preemption analysis. Both *Learjet* and *EPSA* concerned the regulation of matters affecting both wholesale and retail rates, but not the rates or sales themselves. Were *Learjet* applied to a conflict in demand response regulation, then as long as the state regulation does not interfere with FERC regulation, there can be room for both to regulate. This is consistent with the *EPSA* Court's citation to "cooperative federalism" noted with favor.[50]

Hughes is placed in the FERC Direct and State Direct cell, and Field Preemption applied.[51] The Court found the state sponsored CFDs set a price for wholesale capacity, a subject falling under FERC Direct Jurisdiction.[52] The *Hughes* Court was willing to consider the state-sponsored CFDs as a form of direct state regulation of generation. The Court observes that *Mississippi Power & Light* and *Nantahala* makes "clear that States interfere with FERC's authority by disregarding interstate wholesale rates FERC has deemed just and reasonable, even when States exercise their traditional authority over retail rates or, as here, in-state generation."[53]

The *Hughes* Court was clear in declining to consider whether the state regulation (the forms of CFDs) interfered with the wholesale capacity market.[54] It is reasonable to interpret this as the Court's finding that Field Preemption applied and there was no need to engage in a Conflict Preemption analysis.

The Three Decisions do not address facts involving states acting within their Direct Jurisdiction in conflict with FERC acting under its Indirect Jurisdiction. The *EPSA* Court provides its answer in what may be termed *dicta*:

> The above conclusion [that FERC was acting within its affecting or Indirect Jurisdiction] does not end our inquiry into the Commission's statutory authority; to uphold the Rule, we also must determine that it does not regulate *retail* electricity sales. That is because, as earlier described,

[50] *See id.* at 779.

[51] *See Hughes*, 136 S. Ct. at 1298 n.11.

[52] Capacity can be sold without actually selling energy, such as in situations where the energy is too expensive and not needed. An argument could be made that the sale of capacity *affects* sales of energy but does not *constitute* a sale of energy. For purposes of this article, we do not address this issue because it was not raised in *Hughes*.

[53] *Hughes*, 136 S. Ct. at 1299 citing *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354 (1988), *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 106 S. Ct. 2349, 90 L. Ed. 2d 943 (1986).

[54] *See Hughes*, 136 S. Ct. at 1298 n.11.

> §824(b) "limit[s] FERC's sale jurisdiction to that at wholesale," reserving regulatory authority over retail sales (as well as intrastate wholesale sales) to the States. FERC cannot take an action transgressing that limit no matter how direct, or dramatic, its impact on wholesale rates.[55]

This is not surprising. It would be odd if a conflict between actions under FERC Indirect Jurisdiction could preempt actions under State Direct Jurisdiction. With the right facts and imperatives, it may be possible that inconsistent state regulation interferes with imperative Federal regulation under FERC Indirect Jurisdiction so as to tempt the Court to apply Conflict Preemption. Alternatively, the Court may take an expansive view of what constitutes a wholesale sale or transmission so that it can find the case falls under FERC Direct Jurisdiction. The recent trilogy does not address this fact pattern.

Learjet informs us that so long as an activity is not within FERC's Direct Jurisdiction, even if it significantly affects wholesale rates subject to FERC jurisdiction, states may also regulate that activity, so long as it does not interfere with FERC's regulation. *EPSA* informs us that matters over which FERC may regulate wholesale market aspects may involve the retail market. The bounds of this potential for dual regulation will be tested in the coming decade as states endeavor to promote clean energy sources and litigate cases involving existing renewable portfolio standards and the pricing of renewable energy; demand response; and, as explored extensively in the next section, credits for low or zero emission energy sources.

IV. Current Debate: State Support for Nuclear Generators

Undaunted by what preemption obstacles the Three Decisions may pose, several states in eastern organized markets are either advancing or considering different policies to assist in-state generators. In these states and elsewhere, large-scale energy generators, such as coal-fired power plants and nuclear energy generators, are finding it difficult to recover their revenues in energy and capacity markets flooded with cheap natural gas and fuel-free renewable energy generation.

The motivating forces behind these state policies range from a combination of job-

[55] *EPSA*, 136 S. Ct. at 775 (internal citations omitted).

retention,[56] environmental protection,[57] baseload preservation,[58] and ensuring fuel diversity.[59] Various state actions are discussed in Part V, but this Part will explore actions taken by New York and Illinois to bolster their in-state nuclear generators, the subsequent legal challenges raised, and how the above-noted preemption matrix may be applied to anticipate how these cases may be resolved.

A. New York

On August 1, 2016 the New York Public Service Commission ("NYPSC") issued an order adopting a Clean Energy Standard ("CES") encompassing various sustainable energy policies including a Zero-Emission Credit ("ZEC") Program—the first such policy explicitly designed to assist financially "at-risk" nuclear energy generators. In the time leading up to the NYPSC proceeding, the Exelon-owned Fitzpatrick, Ginna, and Nine Mile nuclear energy generators in the state announced that they were considering shutting down due to low prices in the energy and capacity markets administered by the New York Independent System Operator, Inc. ("NYISO").[60]

In apparent recognition that the state would not be able to achieve its ambitious climate change goals without the 27.6 million MWh of annual carbon-free generation cumulatively provided by the three generators,[61] the NYPSC adopted the ZEC program in its August 2016 order.

Under the NYPSC's order, nuclear generators will be eligible to sell ZECs for extra revenue on the basis of certain "public necessity" factors, including: that the generator has a history of contributing to the clean energy resource mix consumed by in-state retail consumers, and that existing energy, capacity, and ancillary services revenues are "insufficient to provide adequate compensation to preserve the zero-emission

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[56] *See, e.g.* Energy Power Supply Ass'n, v. Anthony Star et al., Complaint (E.D. Ill.) Case No. 17-cv-01164 at 27 ("Indeed, when he signed the bill into law, Governor Rauner expressly stated, 'The Future Energy Jobs bill protects taxpayers, ratepayers, and the good- paying jobs at the Clinton and Quad Cities' plants.'") [*hereinafter* Illinois ZEC – Complaint]; Keith Goldberg, *FERC Blocks Ohio Coal Plant Subsidy Deals*, LAW360 (Apr. 27, 2016) https://www.law360.com/articles/790024/ferc-blocks-ohio-coal-plant-subsidy-deals; *Elec. Power Supply Ass'n et al. v. FirstEnergy Solutions, Corp.*, 155 FERC ¶ 61,101 at P 41 (2016) (noting the job-retention and creation benefits advanced by advocates for a coal-plant subsidy arrangement).

[57] N.Y. Pub. Serv. Comm'n, Order Adopting a Clean Energy Standard, CASES 15-E-0302 & 16-E-0270, (Aug. 1, 2016) at 1 (stating the goal of "preserv[ing] existing zero-emissions nuclear generation resources as a bridge to the clean energy future.") [*hereinafter* NYPSC August 1, 2016 Order]

[58] *See, e.g.* Gavin Bade, *Re-regulation on the horizon? State plant subsidies point to looming 'crisis' in organized power markets*, UTILITY DIVE (Oct. 20, 2016) www.utilitydive.com/news/re-regulation-vertically-integrated-utility/428639/ (noting the growing state concern over the increasing retirement levels of large baseload generators due to uneconomic market conditions).

[59] *Id*.

[60] Robert Walton, *With Clean Energy Standard, New York looks to save nukes, skirt legal challenges*, UTILITY DIVE (Aug. 4, 2016) www.utilitydive.com/news/with-clean-energy-standard-new-york-looks-to-save-nukes-skirt-legal-chall/423673/

[61] *Id*.

environmental values or attributes historically provided by the facility."[62] Eligible generators—that is, currently the Fitzpatrick, Ginna, and Nine Mile Point nuclear facilities— enter into 12-year contracts with the New York State Energy Research and Development Authority ("NYSERDA") and receive one ZEC for each MWh of production. New York load-serving entities must either contract with NYSERDA or with the nuclear generators directly to ultimately purchase the number of ZECs proportionate with their load share in the state.

Because only a handful of in-state nuclear plants are eligible for ZECs, the NYPSC reasoned that it was not feasible to allow ZEC prices to be determined by market forces.[63] As such, the NYPSC ordered ZEC prices to be set at varying levels every two years. For the first two years—what the order calls "Tranche 1"—the price will be based on the Social Cost of Carbon ("SCC") as published by the U.S. Interagency Working Group minus any carbon-credit revenues collected through the Regional Greenhouse Gas Initiative. Thereafter, ZEC prices will be based on several factors including the estimated SCC for that year, the amount of renewable energy being consumed in the state, as well as the market revenue forecasts for the associated two-year period.[64]

The ink on the NYPSC order was barely dry before the first legal challenges were raised. A group of generators, led by the Coalition for Competitive Electricity, filed a complaint in the Southern District of New York arguing that the ZEC program is preempted by the FPA and violates the dormant Commerce Clause.[65] Squarely in the crosshairs is the NYPSC's ZEC pricing scheme, which the critics argue, on the basis of *Hughes*, will "profoundly disrupt the FERC-approved energy-market auction structure" in the state by subsidizing uneconomic nuclear generators that otherwise would not be able to compete against other generators.[66]

The NYPSC and various intervenors, in turn, filed motions to dismiss and argued, among other grounds, that the FPA reserves to states the right to regulate the sale of unbundled environmental attributes of generation—here, the zero-emissions characteristics of the nuclear energy—and that the ZEC prices are sufficiently "untethered" from the wholesale market. Unlike the CFDs in *Hughes*, defendants argued, the ZECs are not tied to the nuclear plants' bidding into or clearing NYISO's auctions.[67]

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[62] NYPSC August 1, 2016 Order, *supra* note 57 at 124.

[63] *Id*. at 4.

[64] *Id*. at 129-141.

[65] Coalition for Competitive Electricity et al. v. Zibelman et al. (1:16-cv-08164-VEC) (S.D. N.Y. Oct. 19, 2016) [*hereinafter*, New York ZEC – Complaint]. A separate state court challenge brought by a New York state environmental group alleges that the ZEC program is not "just and reasonable," that it unfairly discriminates against renewable energy generators, and that it was not adopted according to proper procedures. *In Re Hudson River Sloop Clearwater Inc. et al*., Amended Verified Petition, (Index No. 07242-16) (N.Y. Supreme Court).

[66] New York ZEC – Complaint, *supra* note 65 at 3.

[67] Coalition for Competitive Electricity et al. v. Zibelman et al. (1:16-cv-08164-VEC) (S.D. N.Y. Dec. 14, 2016) (Memo in support of Motion to Dismiss) at 19-21.

Oral argument on the motions to dismiss was set for late March 2017,[68] and several parties have intervened and filed briefs in support of the parties' different positions. As of this writing, no decision on the motion to dismiss has been issued and the case remains ongoing.

B. Illinois

The second such example of a state subsidizing nuclear energy generators, and the resulting legal challenges, can be found in Illinois. On December 7, 2016, the governor signed the Future Energy Jobs Act ("FEJA"), which, along with impacting various power industry sectors like efficiency and net metering, established a subsidy program for two of the state's struggling nuclear power plants, Clinton and Quad Cities. Exelon, the owner of both plants (as well as the New York plants noted above), had announced plans to retire the nuclear facilities in 2017 and 2018 due to their failure to compete against cheap renewable and natural gas in the PJM and Midcontinent Independent System Operator ("MISO") markets—a failure resulting in revenue losses totaling around $800 million over the past seven years.[69] After several previous legislative attempts, the FEJA passed and established a ZEC scheme similar to that established by the NYPSC.

Based on legislative findings regarding the environmental and public health-related benefits stemming from carbon-free electricity generation, the Act requires Illinois electric utilities to procure ZECs equal to 16% of their share of annual in-state electricity distribution.[70] ZECs are only tied to nuclear generation under the law, and the Illinois Power Agency ("IPA") selects what in-state nuclear generators are eligible to sell ZECs based on various "public interest criteria" such as minimizing carbon dioxide pollution and preserving existing environmental benefits "including the preservation of zero emission facilities."[71]

Like the NYPSC program, the price of the Illinois ZECs is set by formula that is based on the Social Cost of Carbon, which will increase by $1/MWh each year starting in 2023, and adjusted according to wholesale energy and capacity futures price indices for PJM and MISO beginning in 2018.[72] In effect, the State Defendants would later

[68] Order (Feb. 16, 2017).

[69] Peter Maloney, Why Exelon's mammoth Illinois energy bill could set a precedent for other states, Utility Dive (Dec. 12, 2016) www.utilitydive.com/news/why-exelons-mammoth-illinois-energy-bill-could-set-a-precedent-for-other-s/432089/

[70] 20 ILCS 3855/1–75(d–5); 20 ILCS 3855/1–10.

[71] 20 ILCS 3855/1–75(d–5)(1)(C).

[72] As set out in 20 ILCS 3855/1–75(d–5)(1)(B):

> The price for each zero emission credit procured under this subsection (d-5) for each delivery year shall be in an amount that equals the Social Cost of Carbon, expressed on a price per megawatt hour basis. However, to ensure that the procurement remains affordable to retail customers in this State if electricity prices increase, the price in an applicable delivery year shall be reduced below the Social Cost of Carbon by the amount ("Price Adjustment") by which the market price index for the applicable delivery year exceeds the baseline market price index for the consecutive 12-month period ending May 31, 2016. If the Price Adjustment is greater than or equal to the Social Cost of Carbon in an applicable delivery year, then no

summarize, "if wholesale energy and capacity prices go up, thereby likely increasing a nuclear power plant's operating income from producing and selling energy and capacity and decreasing its need for ZEC revenues to stay in operation, those ZEC revenues — and the corresponding economic cost passed along to Illinois customers — go down."[73]

On February 14, 2017, the Electric Power Supply Association ("EPSA") and a group of companies with generators that compete in the PJM and MISO markets filed a challenge in the U.S. District Court for the Northern District of Illinois.[74] Much like with the New York District Court challenge, the plaintiffs argued that, among other legal infirmities, the ZEC program is both field and conflict preempted by the FPA due to its likely impact on PJM and MISO wholesale markets.[75] Plaintiffs took aim at the ZEC pricing structure, which they claimed "establishes a new state-created energy price 'adder' granted only to the 'winners' of the IPA procurement program."[76] Because this "adder," in the plaintiffs' estimation, will only be given if the nuclear generators sell into the relevant wholesale markets, it therefore is "directly tethered to the wholesale price of electricity."[77]

Several parties, including Illinois Commerce Commission Commissioners, and Exelon Generation Company, LLC, filed motions to dismiss the Plaintiffs' challenge. One such motion was filed in April by the Illinois Attorney General and Assistant Attorney General ("State Defendants"). In the motion's supporting memorandum, the State Defendants reiterated that although "activities subject to federal and state regulation, respectively, often affect each other,[78] the ZEC program nonetheless falls outside the "narrowly construed" scope of FERC's exclusive authority as explained in *Learjet, EPSA*, *Hughes*.[79]

On Plaintiffs' Field Preemption claims, the State Defendants argued that, similar to the legal basis underpinning Renewable Energy Credits ("RECs"), the ZEC program "recognizes and creates property interests in, the environmental benefits of zero-emission power generation."[80] The State Defendants distinguished the ZEC Program from Maryland's impermissible CFD law struck down in *Hughes* on the basis that, as they argued, the ZEC program does not regulate interstate sales of wholesale power, but

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payments shall be due in that delivery year.

[73] *Electric Power Supply Ass'n v. Anthony M. Star, et al.,* State Defendants' Memorandum in Support of Motion to Dismiss (E.D. Ill.) (Case No. 17-cv-01164) at 6 [*hereinafter* Illinois ZEC – Motion to Dismiss Memo]

[74] *Id*.

[75] *Id*. at par. 12. The plaintiffs also argued that the ZEC program is unconstitutional under the dormant Commerce Clause—a secondary argument that is outside the scope of this article.

[76] *Id*. at par. 64.

[77] *Id*.

[78] Illinois ZEC – Motion to Dismiss Memo, *supra* note 73 at 10 (citing to *EPSA*, 136 S.Ct. at 766 ("the wholesale and retail markets in electricity are inextricably linked")).

[79] *Id*. at 10.

[80] *Id*. at 11.

instead, separately regulates the sales of the environmental credits.[81] In that way, the State Defendants argued, the ZEC program defeats any Field Preemption claim because it "separates the environmental benefits of nuclear power generation from that power itself, and controls only the creation, purchase, and sale of those environmental benefits, embodied in ZECs, while leaving it to FERC to regulate the rates for interstate wholesale sales of that power."[82]

The State Defendants relied on a similar argument to counter Plaintiffs' Conflict Preemption challenge. That is, the State Defendants argued, because the ZEC program regulates sales of state law property interests—the environmental benefits of emissions-free generation, as embodied in the ZECs—such sales are outside FERC's jurisdiction over wholesale sales of energy in interstate commerce.[83] In contrast, they argued, is the demand response order at the heart of EPSA, which the Supreme Court held was appropriately under FERC's jurisdiction because "every aspect of the regulatory plan happens exclusively on the wholesale market."[84] The State Defendants reiterated analogies to FERC-approved REC programs, which allow for separate sales of *different* environmental benefits—renewable energy, instead of zero-emission energy. Because such sales were "unbundled" from the electricity, FERC determined that they were outside of its jurisdiction. Likewise, State Defendants argued, because ZECs represent environmental property interests owned by the state, they should be treated similarly.

Although both the New York and Illinois ZEC cases are similar, they diverge in at least one significant respect: the positions taken by the independent system operators that operate the wholesale energy and capacity auctions impacted by Programs. Unlike the NYISO, which recently hailed the New York ZEC program as a necessary "bridge" toward market-based carbon emission controls,[85] PJM has taken the opposite approach toward Illinois' ZEC program, arguing in an amicus brief filed with the Illinois court that the program "will substantially harm the wholesale electricity markets that PJM operates, as well as the investors, competitive energy providers, and (ultimately) consumers that rely on PJM's markets to provide adequate and reliable electricity at the lowest efficient price."[86] Clearly curious about where FERC stands on the matter, on April 24, 2017, the Illinois Federal District Court invited the Commission to submit an amicus brief on "the intersection of Illinois's Zero Emission Credit program and the Federal Power Act and/or FERC's jurisdiction over wholesale electricity sales."[87] FERC declined the invitation,

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[81] *Id*. at 12.

[82] *Id*. at 13.

[83] *Id*. at 13.

[84] *Id,* at 14 (citing EPSA, 136 S.Ct. at 776).

[85] Comments of Bradley C. Jones, President and CEO of NYISO, *State Policies and Wholesale Markets Operated by ISO New England Inc., New York Independent System Operator, Inc., and PJM Interconnection, L.L.C.* (Docket No. AD17-11) at 2

[86] *Electric Power Supply Ass'n v. Anthony M. Star, et al.,* Amicus Brief of PJM LLC, (E.D. Ill.) (Case No. 17-cv-01164) at 1 [*hereinafter* Illinois ZEC – PJM Amicus Brief].

[87] *Electric Power Supply Ass'n v. Anthony M. Star, et al.,* Notification of Docket Entry (Apr. 24, 2017), (E.D. Ill.) (Case

however, citing its current lack of quorum and that a complaint regarding the Illinois ZEC program is pending before the Commission.[88] As of this writing, the motions to dismiss are still under consideration.

C. Discussion of New York and Illinois Cases within the Three Decisions Framework

Of the Supreme Court's Three Decisions, the New York and Illinois Federal District Courts will likely rely most heavily on *Hughes* in their analysis of the ZEC programs. Like with the CFDs at issue in *Hughes*, the key inquiry in the New York and Illinois cases will be whether the ZEC pricing scheme is sufficiently "untethered to a generator's wholesale market participation," as to avoid Field Preemption problems.[89]

As noted, advocates for both the New York and Illinois ZEC Programs argue that *Hughes* is inapplicable because the programs do not set wholesale power prices, unlike Maryland's impermissible CFDs. Instead, they maintain, the ZEC Programs compensate eligible nuclear generators for the environmental benefits represented in their zero-emission power—a regulatory action well within the state's Direct Jurisdiction, they argue. For support, they analogize to REC schemes, which are sold unbundled from the energy sales themselves—and thus, are similarly outside FERC's jurisdiction.

The courts will have to resolve the extent to which the ZEC pricing schemes factor-in, and fluctuate according to, wholesale market conditions. Although these schemes may not be as directly tied to wholesale market compensation as the Maryland CFDs, there may still be enough of a "tether" to warrant Field Preemption à la *Hughes*.

Notably, however, even if the ZEC programs do not fall to Field Preemption under *Hughes*—that is, they are "untethered to a generator's wholesale market participation"—they could nonetheless be vulnerable on Conflict Preemption grounds. That is, the ZEC Programs could be deemed "obstacle[s] to the accomplishment and execution of the full purposes and objectives of Congress."[90] Thus, just as in *Learjet*, the ZEC Programs may clear one preemption hurdle only to find another waiting in the wings.[91] In that event, ZEC opponents would likely argue that out-of-market subsidies, even if to advance legitimate state goals like environmental protection, "stand[] as an obstacle" to Congress's purpose and objective of establishing just and reasonable wholesale rates. Time will tell

No. 17-cv-01164) at 1.

[88] *Electric Power Supply Ass'n v. Anthony M. Star, et al.,* LETTER from David L. Morenoff, General Counsel, Federal Energy Regulatory Commission dated 4/26/17, (E.D. Ill.) (Case No. 17-cv-01164) at 1-2.

[89] *Hughes*, 136 S. Ct. at 1299.

[90] *Id.* at 1297 (quoting *Crosby v. National Foreign Trade Council*, 530 U. S. 363, 373, 120 S. Ct. 2288, 147 L. Ed. 2d 352 (2000)).

[91] As noted *supra* note 27, following *Learjet*, the District Court on remand held that there was no Conflict Preemption either, primarily because the state laws were stricter than the federal law and did not interfere with the implementation of the federal law.

whether the ultimate outcome will be different than in *Learjet*.

Re-Populated Jurisdiction-Preemption Matrix

	FERC Direct Jurisdiction	FERC Indirect Jurisdiction
State Direct Jurisdiction	*Hughes* - Field Preemption ZEC Cases?	*EPSA* dicta - No Preemption ZEC Cases?
State Indirect Jurisdiction		*Learjet* – Conflict Preemption *EPSA*

Where the New York and Illinois ZEC cases fall in the framework will be a matter for the courts to determine. The type of preemption analysis depends on the nexus between the purported State Jurisdiction and the purported FERC Jurisdiction. For example, if New York and Illinois are found to be operating within the FPA's "State Savings Clause" (due to their regulatory control over the in-state nuclear generators) but are nonetheless setting a wholesale price for energy or capacity through the ZEC Program, this would raise the same Field Preemption concerns in *Hughes*. Similarly, if the states are not deemed to be setting wholesale rates, but their nuclear "subsidies" are nonetheless "affecting" FERC-jurisdictional wholesale markets, that could trigger a Conflict Preemption analysis, and the ZEC Programs would be preempted to the extent that they "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[92] It also remains to be seen whether FERC would consider such a case as an invitation to exercise its market mitigation authority, explained further infra Part V.A, *infra*.

V. Other Recent Developments and Looming Challenges

Outside federal court challenges, the two other common ways through which state generator subsidies can be legally challenged are through petitions to FERC for application of mitigation measures and through the state courts on state law grounds. Although federal preemption issues loom less large in those cases, they do nonetheless have real-world implications for generators, stakeholders, and other market participants, as such subsidies can be rendered moot through mitigation or tossed out entirely if, for example, the state utility commission did not follow appropriate procedures.

Notably, these avenues are not mutually exclusive. Indeed, as explored next, the New York and Illinois plaintiffs are challenging their respective state ZEC program through federal preemption actions in federal court and petitions before FERC for market mitigation.

[92] *Hughes*, 136 S. Ct. at 1299; *Learjet*, 135 S. Ct. at 1599.

A. FERC Challenges and other Developments

Unlike the preemption challenges explored earlier, the petitions brought to FERC do not focus on whether states have the authority to establish subsidies through ZEC programs or other mechanisms. Rather, petitions brought to FERC ask the narrower question of whether the wholesale energy and capacity market prices have become unjust and unreasonable under the FPA as a result of the purported price suppression from the state subsidies. In the event that FERC does determine that such prices have now become unjust and unreasonable, it must order corrective action.

In the case of the eastern organized markets, FERC's corrective action has often taken the form of requiring the relevant RTO or ISO to institute buyer-side market mitigation. Although each entity administers mitigation differently, generally speaking, the objective of such a policy is to prevent buyers—that is, load-serving entities—from acquiring "uneconomic" generation resources that effectively suppress clearing prices and drive out other, more economic, generators. Although not everyone is satisfied with buyer-side market mitigation—indeed, several present and former FERC Commissioners have opined on the policy's weaknesses[93]—until a replacement mechanism is put into place, it will remain the primary tool to counterbalance the market impact of state-subsidized generators.

As of this writing, both proceedings set out below are still ongoing. However, due to the Commission's current lack of the required three-Commissioner quorum needed to vote,[94] it is unlikely that these complaints will be resolved before new Commissioners are appointed.

i. New York

In January 2017, EPSA requested that FERC order NYISO to modify its Service Tariff to mitigate uneconomic generators largely funded by out-of-market contracts and subsidies, namely, ZECs.[95] The original complaint, filed in 2013 and challenging out-of-market revenues to certain nuclear-powered generators, took on new urgency for EPSA following the NYPSC's ZEC order. In its request for action, EPSA leaned heavily on previous FERC decisions finding, and ordering mitigation to remedy, uneconomic entry of generators to have artificially depressed market prices to an unjust and unreasonable level.[96]

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[93] *See, e.g. New York Pub.Sev. Comm'n v. New York Indep. Syst. Op,* 158 FERC ¶ 61,137 (2017) (Comm'r Bay, concurring) (recommending that the Commission "reconsider[] the MOPR's rationale and applicability in the wholesale electricity markets"); *New England States Comm. on Elec. v. ISO New England, Inc.,* 142 F.E.R.C. ¶ 61,108 (2013) (Comm'r Norris dissenting) (questioning whether ISO-NE's MOPR appropriately accommodates states' ability to accomplish their own policy goals).

[94] *Order Delegating Further Authority to Staff in Absence of Quorum,* 158 FERC ¶ 61,135 (2017).

[95] Indep. Power Prod. of N.Y. v. NYISO, Docket No. EL13-62-002, Request for Expedited Action (Jan. 9, 2017) [*hereinafter*, NY ZEC – FERC Complaint].

[96] Id. at 13, 15 (citing PJM Interconnection, L.L.C., 128 FERC ¶ 61,157 at P 91 (2009); ISO New England, Inc., 135

As EPSA argued, the ZECs similarly allowed otherwise uneconomic generators to persist in the market. Indeed, it argued "there is no sign that either the amount of capacity procured under or the direction of the ZECs contracts corresponds to any legitimate reliability need."[97] Thus, EPSA requested that FERC act quickly and order NYISO to file tariff revisions to address artificial price suppression by uneconomic generators. Otherwise, it argues, "[l]eaving this threat unaddressed will lead to the further tilting of the playing field."[98]

ii. Illinois

Similarly, the same parties that challenged the Illinois ZEC program in federal court also filed a petition with FERC on January 9, 2017.[99] The complainants sought leave to amend an earlier complaint initially challenging Ohio coal-fired power subsidies and shift its focus to Illinois' ZEC Program.[100] The complainants requested that FERC direct PJM to extend its Minimum Offer Price Rule ("MOPR") to apply to the ZEC program subsidies. They argued that the ZEC Program posed a threat to PJM's capacity market, the Reliability Pricing Model ("RPM") market, through which generators bid for the opportunity to provide generation for a "delivery year" set three years after each annual auction. PJM's next annual capacity auction, called the Base Residual Auction ("BRA"), was scheduled for May 2017 and intended to satisfy the region's capacity needs for the 2020/2021 delivery year. The complainants requested that FERC direct PJM to adopt buyer-side mitigation in time for the 2020/2021 BRA "to ensure that State-approved subsidies to favored existing resources do not artificially suppress prices in that auction."[101]

Borrowing heavily from the FERC complaint challenging the New York ZEC Program, the complainants in this proceeding argued that the Illinois program would amount to a subsidy of roughly $374 million for the two Exelon-owned nuclear-powered generators. Likewise with the other FERC complaint, the Illinois complainants highlighted that, among the factors to be considered in the ZEC-procurement process was "the preservation of zero emission facilities"—implying that the Program is intended to keep

FERC ¶ 61,029 at P 170 (2011) (footnotes omitted), *on reh'g*, 138 FERC ¶ 61,027 (2012)).

[97] NY ZEC – FERC Complaint, *supra* note 94 at 10.

[98] *Id*. at 12.

[99] Motion to Amend, and Amendment to, Complaint and Request for Expedited Action on Amended Complaint, Docket No. EL16-49 (filed Jan. 9, 2017) [*hereinafter*, Illinois ZEC – FERC Complaint].

[100] The initial complaint challenged ratepayer-subsidies approved by the Public Utility Commission of Ohio for certain finically struggling coal plants owned by American Electric Power Company, Inc. ("AEP") and FirstEnergy Corporation, and included a request for PJM to expand its MOPR to those existing resources. FERC did not reach the merits of that complaint, however, but instead rescinded waivers of affiliate power sales restrictions that it had previously granted to AEP and FirstEnergy. *Elec. Power Supply Ass'n v. AEP Generation Res, Inc.,* 155 FERC ¶ 61,102 (2016); *Elec. Power Supply Ass'n v. FirstEnergy Sol. Corp.,* 155 FERC ¶ 61,101 (2016). The subsidy arrangement foundered without the waivers, and the utilities moved to close the docket on mootness grounds. The complainants fought the docket's closure, arguing that the issue of subsidies within the PJM region was likely to recur—a prediction that came true with the passage of the Illinois law and ZEC Program in December 2016.

[101] Illinois ZEC – FERC Complaint, *supra* note 98 at 3.

otherwise-uneconomic generators from retiring.[102] Although the Illinois ZEC Program would not be effective until June 1, 2017, the complainants expressed their expectation that, regardless, "Exelon will offer the Quad Cities Generating Station's capacity into the 2020/2021 BRA fully confident that it will receive zero emission credits during the 2020/2021 Delivery Year."[103] Thus, the complainants urged FERC to apply PJM's MOPR to existing resources—as opposed to only new resources, as has been the practice.[104]

Since the January 2017 filing, there has been a flurry of motions to intervene, dismiss, and otherwise respond to the amended complaint. Among the intervening parties have been Exelon and the Illinois Attorney General. In opposing complainants' amended complaint, these opponents raise, among other arguments, the fact that PJM's MOPR has never been applied to existing resources.[105] As Exelon explained, market mitigation of existing resources would be counter-intuitive because their supply is already participating in the market and contributing to the price structure that FERC has already deemed just and reasonable.[106] Furthermore, Exelon continued—echoing claims raised by the Illinois defendants—it would be inappropriate for FERC to intervene in "a legitimate effort by Illinois to promote state environmental goals."[107]

ZEC opponents have focused on the manner in which ZECs set prices received by wholesale capacity suppliers, tethering, and the impacts on the wholesale market associated with subsidized retention of uneconomic generation. This challenge is also on hold pending the establishment of a quorum at FERC and may be delayed further as new commissioners get up to speed on such an important topic.

iii. Technical Conference: May 1-2, 2017

In acknowledgment of the growing concerns over state policy impacts on federally-regulated wholesale energy and capacity markets, on May 1-2, 2017, FERC staff held a technical conference to discuss this problem particularly in relation to ISO New England Inc. ("ISO-NE"), NYISO and PJM. The goal of the conference was to explore how these competitive wholesale markets can facilitate the participation of resources favored by their constituent states. Stakeholders from various sectors of the electricity industry attended to express frustration with or concern over these eastern organized markets—with a regulatory response from FERC unlikely to take place until at least a three-Commissioner quorum is established.

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[102] *Id*. at 8.

[103] *Id.* at 17.

[104] *Id.* at 17-18.

[105] Protest of Exelon Corporation, Docket No. EL16-49 (filed Jan. 30, 2017) at 4; see also Opposition and Comments of the People of the State of Illinois to the Amended Complaint and Support of the Motion to Dismiss filed by Dayton Power and Light et al., Docket No. EL16-49 (filed Jan. 30, 2017).

[106] Protest of Exelon Corporation, Docket No. EL16-49 (filed Jan. 30, 2017) at 4, 18.

[107] *Id*. at 4; see also Opposition and Comments of the People of the State of Illinois to the Amended Complaint and Support of the Motion to Dismiss filed by Dayton Power and Light et al., Docket No. EL16-49 (filed Jan. 30, 2017).

B. State-Level Challenges

The NYPSC ZEC Program in particular is not just facing challenges in federal court or before FERC, instead, state environmental groups have jumped aboard and filed a challenge in state court as well. On November 30, 2016, attorneys for the environmental group Hudson River Sloop Clearwater sued the NYPSC over the ZEC Program, arguing that, among other infirmities, the Order will lead to unjust and unreasonable retail rates, and that it was not issued according to required administrative procedures. In particular, as the environmental petitioner argued, the ZEC Program "contains many deficiencies, including implementing a program beyond the legal authority of the PSC, numerous assumptions and statements not supported by any technical basis, errors of fact and legal procedural defects preventing public comment and review in violation of multiple sections of the State Administrative Procedures Act,"[108]

C. Other State Action and Potential Challenges?

While parties spar over the New York and Illinois ZEC Programs in federal court, state court, and before FERC, states are taking other creative steps to bolster financially struggling generators, as well as ensure better fuel diversity and resource adequacy. These state actions are occurring at a time of significant jurisdictional uncertainty. As such, some states like Massachusetts and Connecticut are resorting to procurement mandates. Michigan, New Jersey, and Pennsylvania are taking other approaches to subsidizing existing generators. These cases promise to better define the law of preemption and jurisdiction as *Learjet*, *EPSA*, and *Hughes* spawn progeny in the courts.

i. Ohio

Following a protracted and contentious administrative proceeding, in March 2016 the Public Utilities Commission of Ohio ("PUCO") approved proposals from AEP and FirstEnergy to keep operational a group of seven coal plants and one nuclear plant through eight-year-long power purchase agreements ("PPAs").[109] This decision from the PUCO prompted the initial complaint to FERC, which, as noted, preceded the current Illinois ZEC program challenge now before the Commission.[110] Although preemption and market mitigation issues loomed large with those PPAs, those issues were sidestepped when FERC rescinded waivers it had granted to the two companies that had allowed them to purchase power from their affiliate generators. Absent a waiver, the utilities would be required to obtain FERC review of, and approval under a stringent "affiliate abuse" test, for each power purchase through the PPAs.

After FERC essentially blocked the PPAs from moving forward, FirstEnergy secured from PUCO a three-year-long $204 million/year surcharge that will be applied at

[108] *In Re Hudson River Sloop Clearwater & Goshen Green Farms LLC against NYPSC et al*., Index No. 007242/2016, at 4, *available at* http://www.clearwater.org/wp-content/uploads/2009/11/PSC-Tier-3-Art.-78-version-16-Final.pdf.

[109] Pub. Util. Comm'n of Ohio, Opinion and Order, In Re Application of Ohio Edison Co. et al., (Case No. 14-1297-EL-SSO) (Mar. 31, 2016) dis.puc.state.oh.us/TiffToPDf/A1001001A16C31B41521H01842.pdf

[110] Complaint Requesting Fast Track Processing, Docket No. EL16-49-000 (filed Mar. 21, 2016).

the distribution-level, which falls outside FERC's jurisdiction.[111] For its part, AEP began pursuing a two-part approach to resolving its financial dilemma: seeking a buyer for all of its Ohio plants and advocating alongside FirstEnergy for re-regulating the state's energy markets—that is, reestablish the vertically-integrated utility model whereby utilities were assured a rate of return in exchange for more control over their generation procurement and other activities.[112] After AEP was eventually able to sell its plants, the utility dropped its ambitious re-regulation proposal and opted for a more "surgical" legislative fix to address its remaining cost-recovery issues, with legislation expected to be announced later in 2017.[113]

Meanwhile, in February 2017, FirstEnergy offered support for another ZEC program in order to keep its two nuclear power plants operating.[114] As initially envisioned, retail consumers would see their monthly bills increase about 5% as a result of $300 million in yearly subsidies to First Energy. Just as illustrated by the New York and Illinois programs, any ZEC or nuclear subsidy program passed legislatively or administratively in Ohio will likely be hotly contested.

ii. Massachusetts

In a bid to help wean itself from an over-dependence on natural gas, and provide sustainable energy replacements for closing the Brayton Point coal plant and the Pilgrim nuclear energy generator, on August 8, 2016, Massachusetts passed a landmark clean energy bill addressing off-shore generation and hydro.[115] Under the new law, the state solicits long-term Power Purchase Agreements for 1,600 MW of offshore wind power and an additional 1,200 MW of hydro or other renewable power.[116]

iii. Connecticut

In March 2017, Connecticut state legislators released a proposed bill that would allow the state's one nuclear energy plant, Dominion Energy-owned Millstone Station, to be considered a "Class I" renewable, alongside wind and solar resources, under the

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[111] John Funk, *PUCO gives FirstEnergy up to $200 million in surcharges a year for three years, and chance to extend increases an additional 2 years*, CLEVELAND PLAIN DEALER (Oct. 12, 2016) www.cleveland.com/weather/blog/index.ssf/2016/10/puco_gives_firstenergy_up_to_2.html

[112] Kathiann M. Kowalski, *Report: 'Around market' moves by Ohio utilities are part of larger trend*, MIDWEST ENERGY NEWS (Sept. 14, 2016) midwestenergynews.com/2016/09/14/report-around-market-moves-by-ohio-utilities-are-part-of-larger-trend/

[113] Robert Walton, *AEP to push 'surgical' approach to power market reforms in Ohio*, UTILITY DIVE (Jan. 27, 2017)www.utilitydive.com/news/aep-to-push-surgical-approach-to-power-market-reforms-in-ohio/434927/; Robert Walton, *AEP CEO: Ohio re-regulation off, but plant support bills on tap in Q3, Q4,* UTILITY DIVE (Apr. 28, 2017)www.utilitydive.com/news/aep-ceo-ohio-re-regulation-off-but-plant-support-bills-on-tap-in-q3-q4/441513/

[114] John Funk, *FirstEnergy to seek "zero emission credits" for its 2 Ohio nukes*, CLEVELAND PLAIN DEALER (Feb. 21, 2017) www.cleveland.com/business/index.ssf/2017/02/firstenergy_asking_for_zero_em.html

[115] *Governor Baker Signs Comprehensive Energy Diversity Legislation* (Aug. 8, 2016) www.mass.gov/governor/press-office/press-releases/fy2017/governor-baker-signs-comprehensive-energy-diversity-law.html

[116] *Id*.

state's Renewable Portfolio Standard ("RPS").[117] If passed into law, the facility would be eligible to participate in the renewable energy procurement process. In addition, the state's RPS would increase and utilities would be required to secure 20% of their total procurement from renewable sources, 29% by 2029, and 40% by 2040. Supporters of the bill stress that Millstone Station accounts for a significant portion of the state's baseload generation and that, like nuclear power generators throughout Eastern organized markets, it is getting outbid by cheap natural gas and true renewable generators. Critics, however, argue that it will unnecessarily compete against wind and solar generators and that Dominion has failed to make a financial case for why ratepayers should be on the hook for a plant that has not shown itself to be as financially vulnerable as other nuclear generators.[118]

iv. Michigan

As more and more coal-fired generators retire in Michigan, state energy officials have been warning of capacity shortfalls. Indeed, 5,000 MW of such generation is expected to retire in the next seven years, and 30% of the state's total generation could be gone within the next 15 years.[119] In mid-December, lawmakers passed energy-related legislation that, among other highlights, addressed the state's retail choice program and increased energy efficiency goals. Chief among the law's provisions was creating a kind of "backup plan" to secure adequate capacity.[120] As part of that plan, utilities will have to submit more robust resource adequacy plans and the state's Public Service Commission ("MPSC") is ordered to open a proceeding to determine whether a "capacity charge" is more cost-effective than MISO's then-pending Forward Capacity Auction proposal that was since rejected by FERC.[121] Under that proposal, MISO's capacity market would have begun holding a forward capacity auction specifically for its competitive retail areas—10% of MISO's total load—to establish load three years ahead of the annual Planning Resource Auction.[122]

MPSC opened the docket on resource adequacy process implementation issues in January 2017.[123] On March 10, 2017 the MPSC issued an order that, among other things, directed staff to develop by August 16, 2017 "recommendations regarding the capacity obligations for load that pays a State Reliability Mechanism ("SRM") charge to a utility, including MISO's annual planning resource auction." The state may have moved

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[117] Michael Kuser, *Connecticut Moves Closer to Equating Nuclear with Renewables*, RTO INSIDER (Mar. 14, 2017) https://www.rtoinsider.com/connecticut-nuclear-renewables-40199/

[118] *Id*.

[119] Amanda Durish Cook & Rich Heidorn Jr., '*Backup Plan,' IRPs Respond to Capacity Concerns*, RTO INSIDER (Dec. 19, 2016) https://www.rtoinsider.com/michigan-energy-bill-35641/

[120] *Id*.

[121] *Id*.

[122] Amanda Durish Cook, FERC Rejects MISO's 3-Year Forward Auction Proposal, RTO Insider (Feb. 2, 2017) https://www.rtoinsider.com/ferc-miso-forward-capacity-auction-37993/

[123] Michigan Public Service Comm'n, Resource Adequacy Process Implementation Case No. U-18239 and Case No. U-18248.

closer to establishing its own "capacity charge" with FERC's rejection of MISO's proposal in early February out of concerns of price volatility and uncertainty.[124]

v. Other States: New Jersey, Pennsylvania

Like New York and Illinois, nuclear generator subsidies are being considered in New Jersey and Pennsylvania as well.[125] For example, emboldened by the current successes—thus far—in New York and Illinois, FirstEnergy and Exelon are pushing for similar nuclear energy subsidies in Pennsylvania.[126] In New Jersey, the Public Service Enterprise Group has stated that it may have to close its fleet of nuclear plants if they do not become more economically viable, either through markets or non-market assistance, in the next three years.[127]

VI. Concluding Thoughts

As Justice Kagan aptly noted in *EPSA*, the statutory division between federal and state jurisdiction under the FPA and NGA continues to generate "a steady flow of jurisdictional disputes" due to the "inextricably linked" nature of wholesale and retail energy markets.[128] In the electricity sector these disputes are only intensifying as states continue pursuing various policy goals through mandates and subsidy schemes impacting electricity markets and investors. Although laudable priorities, the cost of their pursuit is not insubstantial. Merchant generators in particular, and now even system operators like PJM, are growing concerned about out-of-market financial arrangements that allow otherwise uneconomic generators to continue participating in wholesale energy and capacity markets.

It remains to be seen how the New York and Illinois ZEC Program challenges in court or before FERC will be decided, or whether any of the other state actions will also come under fire by critics. Ultimately, time will tell whether the Three Decisions, and their subsequent progeny, will finally provide clarity on these vexing jurisdictional dilemmas.

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[124] *Id*.

[125] Mary Serrez, *Nuclear power subsidies on tap in a growing number of states, including New York and Connecticut*, MASS LIVE (Apr. 9, 2017) www.masslive.com/news/index.ssf/2017/04/nuclear_power_subsidies_on_tap.html

[126] Anya Litvak, *Beaver Valley hangs in the balance of nuclear subsidy efforts in two states*, PITTSBURGH POST-GAZETTE (Mar. 6, 2017) powersource.post-gazette.com/powersource/policy-powersource/2017/04/28/Chesapeake-royalty-deduction-Forba-Pennsylvania-Marcellus/stories/201704270030.

[127] Tom Johnson, *N.J. nuclear plants could go dark without subsidies, PSEG warns*, NJ SPOTLIGHT (Mar. 7, 2017) www.nj.com/news/index.ssf/2017/03/nuclear_plants_could_do_dark_without_subsidies_pse.html

[128] *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760, 766 (2016) ("*EPSA*").

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