Nos. 13-4330 & 13-4501 (consolidated)

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PPL ENERGYPLUS, LLC, *et al.*

v.

LEE A. SOLOMON, in his official capacity as
President of the New Jersey Board of Public Utilities, *et al.*,

v.

CPV POWER DEVELOPMENT, INC.; HESS NEWARK, LLC.

CPV POWER DEVELOPMENT, INC.,
Appellant in No. 13-4330

LEE A. SOLOMON, *et al.*,
Appellants in No. 13-4501

On Appeal from the United States District Court of the District of New Jersey
No. 3:11-cv-007-PGS (Hon. Peter G. Sheridan)

BRIEF OF THE ELECTRIC POWER SUPPLY ASSOCIATION AND THE EDISON ELECTRIC INSTITUTE AS *AMICI CURIAE* IN SUPPORT OF APPELLEES AND AFFIRMANCE OF THE DISTRICT COURT'S JUDGMENT BELOW

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CORPORATE DISCLOSURE STATEMENT AND STATEMENT OF FINANCIAL INTEREST

In accordance with Rule 26.1 of the Federal Rules of Appellate Procedure and Third Circuit Local Rule 26.1, *amici curiae* make the following disclosures:

Electric Power Supply Association ("EPSA"):

EPSA is a national trade association that represents the competitive power industry and is incorporated under the laws of the District of Columbia. There is no parent corporation or any publicly held corporation that owns 10 percent or more of EPSA's stock.

EPSA's members include 16 companies, along with numerous supporting members, and state and regional partners that represent the competitive power industry in their respective regions. EPSA's members have significant financial investments in electric generation and electricity marketing operations across the country. EPSA's organizational purpose is, among other things, to promote a favorable market environment for the competitive electric industry; to support the development of state and federal legislative and regulatory policies that encourage the development and implementation of competitive wholesale markets for electricity; and to improve the public's awareness of the competitive electric industry.

Edison Electric Institute ("EEI"):

EEI is the trade association of the U.S. shareholder-owned electric companies. EEI members serve almost 99 percent of the ultimate customers in the shareholder-owned segment of the industry, and they represent approximately 70 percent of the U.S. electric power industry. EEI's diverse membership includes utilities operating in all regions of the nation. EEI does not have any parent companies, and no publicly-held company has a 10 percent or greater ownership interest in EEI. EEI does not issue stock.

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STATEMENT OF INTEREST[1]

The disposition of this appeal requires a proper understanding of the Federal Power Act's bright line division of jurisdictional authority between state and federal regulators. It also requires a proper understanding of the wholesale markets regulated by the Federal Energy Regulatory Commission ("FERC") and the delicate balance between competing policy objectives that FERC has achieved in approving the market rules for wholesale sales of capacity within the region administered by PJM Interconnection, L.L.C. ("PJM").

Amici the Electric Power Supply Association ("EPSA") and the Edison Electric Institute ("EEI") are two of the power industry's leading trade associations with members that operate across the country, including in the region administered by PJM. Through this brief, they seek to inform the Court of their perspectives on the important preemption issues raised in this appeal. They also seek to emphasize that the district court's judgment below can and should be affirmed without

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[1] All parties have consented to the filing of this brief. No counsel for any party authored this brief in whole or part; no party or counsel made a monetary contribution intended to fund the preparation or submission of this brief; and no person other than *amici curiae* made such a contribution.

impeding appropriate efforts by states to exercise their traditional powers to encourage generation development and promote reliability.

EPSA and EEI have a strong interest in this appeal because the New Jersey statute at issue, the New Jersey Long-Term Capacity Pilot Program Act ("LCAPP"), directly and adversely affects members of EPSA and EEI that participate in the organized wholesale capacity markets. The agreements entered into under the New Jersey statute create incentives for the LCAPP generators to submit below-cost offers into capacity auctions administered by PJM, thereby changing the rate paid to EPSA's and EEI's members in those auctions. More fundamentally, because EPSA's and EEI's members are often subject to regulation at both the state and federal level, they have a significant interest in ensuring that the jurisdictional lines established under the Federal Power Act are properly respected, and that the competitive markets managed by FERC operate properly to the benefit of all participants in the market. They also have a strong interest in ensuring that states are not permitted to interfere with FERC's exclusive authority to regulate the organized wholesale markets in which they participate.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Federal Power Act grants FERC broad and exclusive jurisdiction over the transmission and sale of "electric energy at wholesale in interstate commerce." 16 U.S.C. §§ 824(b), 824d(a), 824e. That authority includes responsibility for ensuring that "rates and charges made, demanded, or received . . . for or in connection with the transmission or sale" of electricity at wholesale are "just and reasonable." *Id.* § 824d(a). It also obligates FERC to eliminate "unduly discriminatory or preferential" practices that might prevent market participants from competing on an even playing field. *Id.* § 824e(a).

Exercising this exclusive authority, FERC has approved a competitive market in the PJM region and market rules designed to ensure that wholesale rates are just and reasonable and not unduly discriminatory. In the PJM capacity markets, the market rules afford each generator an opportunity to compete by participating in a carefully structured annual auction process. Generators bid into the auction, committing to sell capacity, and PJM accepts the bids from lowest until highest (in each locational delivery area within PJM and in the broader PJM market) until it has secured a sufficient supply of capacity. The highest bid PJM accepts to obtain the capacity it needs — *i.e.*, when supply matches demand — becomes the market "clearing price" that is paid to all generators that bid into the auction at or below that price. FERC has determined that the rate set through this market process is just and reasonable. When a supplier submits below-cost offers because it is recovering those costs through payments received outside the market, however, resources that are more economic will be displaced and the clearing price will be artificially suppressed, which will prevent the market from functioning as FERC intended.

Until the late 1990s, New Jersey's utilities were vertically integrated, meaning that the same companies both generated and sold power to state retail consumers. In more recent years, however, New Jersey has voluntarily chosen to end traditional retail regulation and to restructure its markets so that electricity sold to New Jersey consumers is purchased from the organized PJM wholesale market regulated by FERC. By making that decision, New Jersey ensured that its consumers would share in the significant benefits of a competitive market, but it also agreed that it would comply with the market rules established by FERC for PJM's wholesale electric markets.

Against this backdrop, this case requires the Court to consider the legality of a New Jersey statute that changes the rate paid for capacity sold through the organized capacity market administered by PJM and thereby distorts the clearing price paid to other suppliers. The purpose of this brief is to assist the Court by providing an industry-wide perspective on the negative implications of the New Jersey statute on the regulation and operation of organized wholesale markets (such as those administered by PJM). *Amici* agree with appellees that the New Jersey statute impermissibly interferes with the PJM market rules FERC approved to ensure that rates are just and reasonable and not unduly discriminatory.

The brief has three sections: Section I elaborates on arguments advanced in appellees' brief explaining why the New Jersey statute is preempted — both because it invades FERC's field of exclusive jurisdiction over wholesale sales of capacity, and because it conflicts with federal law by interfering with the carefully structured PJM market rules approved by FERC. Section II responds to appellants' two principal arguments against preemption and explains why neither has merit. Section III emphasizes that the Court can affirm the district court's judgment below without impairing a state's ability to take appropriate steps to encourage generation development and promote reliability. This case does not require any curtailment of traditional state authority, but it does require confirming that under the Federal Power Act states have no authority to invade FERC's exclusive jurisdiction by changing the price paid for capacity cleared through the PJM auction process.

ARGUMENT

I. New Jersey's Attempt To Regulate Wholesale Rates Impermissibly Intrudes On FERC's Exclusive Jurisdiction.

The district court correctly concluded that the New Jersey LCAPP statute intrudes on FERC's exclusive jurisdiction because it attempts to change the rate paid for wholesale sales of capacity, and because it seeks to impose the state's policy preferences on the wholesale capacity market regulated by FERC. Under settled principles of preemption law, New Jersey's capacity compensation scheme should not be allowed to stand.

A. The Federal Power Act Grants FERC Exclusive Jurisdiction Over Wholesale Sales Of Electricity.

Under the Supremacy Clause of the U.S. Constitution, state laws that contravene federal law are "void" and "without effect." *Maryland v. Louisiana*, 451 U.S. 725, 746–47 (1981). State laws are preempted "when the scope of a [federal] statute indicates that Congress intended federal law to occupy a field exclusively." *Freightliner Corp. v. Myrick*, 514 U.S.

280, 287 (1995); *see also Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248 (1984). State laws are also preempted when they impermissibly conflict with federal law, either because they "stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 298 (1988), or because "compliance with both federal and state regulations is a physical impossibility." *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142–43 (1963).

In the case of the Federal Power Act, the statutory scheme renders unnecessary any "case-by-case analysis of the impact of state regulation upon the national interest." *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986). The Act grants FERC "*exclusive* authority to regulate the transmission and sale at wholesale of electric energy in interstate commerce," *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340 (1982) (emphasis added); *see also* 16 U.S.C. § 824(a), as well as *exclusive* jurisdiction over any matters that "directly affect[] . . . wholesale rates." *Nantahala*, 476 U.S. at 966–67 (1986); *see also* 16 U.S.C. §§ 824d(a), 824d(c), 824e(a). The Act thus draws a "bright line easily ascertained, between state and federal jurisdiction" and leaves "no power in the states to regulate . . . sales for resale in interstate commerce." *FPC v. S. Cal. Edison Co.*, 376 U.S. 205, 214–16 (1964).

Interpreting these provisions, the Supreme Court has long recognized that the Federal Power Act occupies the field with respect to the transmission and wholesale sale of electric energy in interstate commerce, and that any attempts by states to regulate within that field are preempted. *See, e.g.*, *Entergy La., Inc. v. Louisiana Pub. Serv. Comm'n*, 539 U.S. 39 (2003); *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988); *Nantahala*, 476 U.S. 953. Moreover, in recognition of FERC's exclusive jurisdiction over wholesale sales, the Supreme Court has held that "the right to a reasonable rate is the right to the rate which [FERC] files or fixes . . . ." *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951) (citation omitted). That principle, known as the "filed rate doctrine," is intended to "preserve the agency's primary jurisdiction over reasonableness of rates" by ensuring "that regulated companies charge only those rates of which the agency has been made cognizant," *Arkansas Louisiana Gas Co v. Hall*, 453 U.S. 571, 577–78 (1981), and by prohibiting states from "usurp[ing] a function that Congress has assigned" to FERC. *Id.* at 582.

Contrary to appellants' assertions, *see* CPV Br. 47–48; NJBPU Br. 19, there is no "presumption against preemption" where FERC's jurisdiction under the Federal Power Act is involved. *See* Appellees' Br. 23–24. Interstate electric transactions may be regulated only "by the exercise of the power vested in Congress." *Public Utils. Comm'n of R.I. v. Attleboro Steam & Elec. Co.*, 273 U.S. 83, 90 (1927). Moreover, when Congress enacted the Federal Power Act, it "authorized federal regulation not only of wholesale sales that had been beyond the reach of state power, but also the regulation of wholesale sales" that had "previously been subject to state regulation" because they "did not directly burden interstate commerce." *New York v. FERC*, 535 U.S. 1, 21 (2002). The presumption against preemption is thus inapplicable not only because states were never empowered to regulate interstate sales in the first instance but also because this is an area "where there has been a history of significant federal presence." *United States v. Locke*, 529 U.S. 89, 108 (2000)*; see also Public Util. Dist. No. 1 of Grays Harbor v. IDACORP, Inc.*, 379 F.3d 641, 648 n.7 (9th Cir. 2004) (presumption against preemption "is almost certainly not applicable here because the federal government has long regulated wholesale electricity rates").

B. The New Jersey Statute Is Preempted Because It Sets And Directly Affects Rates For Wholesale Sales.

New Jersey's capacity compensation scheme is preempted for two reinforcing reasons: *First*, by changing the compensation paid for sales of capacity cleared in the PJM market, the New Jersey statute impermissibly invades a field that Congress exclusively reserved to FERC. *Second*, the New Jersey scheme impermissibly conflicts with federal law by interfering with the market rules that govern PJM's capacity market.

1. The New Jersey Statute Impermissibly Changes The Rate Paid For Sales Through PJM's Capacity Auction.

The purpose and practical effect of New Jersey's statute is to change the wholesale rate by compensating generators for capacity they sell in the organized markets administered by PJM at a price that differs from the market clearing price set through the auction process approved by FERC. The state's capacity compensation scheme thus invades the field of FERC's exclusive jurisdiction over the rates "made, demanded, or received . . . for or in connection with" interstate wholesale capacity sales. 18 U.S.C. § 824d(a). It is therefore preempted. *See generally* Appellees' Br. 22–28.

Appellants contend that New Jersey's statute merely encourages certain generators to construct new generation facilities. *See* CPV Br. 37–40; Hess Br. 25–26. In their view, because the state-mandated payments "are not made as part of any sale of capacity in the wholesale market" but are instead "furnished separately, as a subsidy or rebate, . . . in exchange for the generator's agreement to construct a power plant," they do not intrude on FERC's exclusive jurisdiction. CPV Br. 39. But that is not an accurate characterization of what the New Jersey statute requires. The LCAPP contract payments are not just tied to the successful construction of new generating facilities; they also depend on clearing the facilities' capacity through the wholesale capacity auctions administered by PJM. As the New Jersey Board of Public Utilities concedes, the requirements of the state capacity agreements "only come[] into effect, in any given year, if the [generators'] offer to sell capacity 'clears' the PJM Market pursuant to PJM Market rules." NJBPU Br. 7.

Because Congress granted FERC exclusive jurisdiction over wholesale rates, New Jersey cannot alter them either directly as "part of [a] sale of capacity in the wholesale market" or less directly (but no less significantly) by making payments for capacity sold through the PJM market "separately, as a subsidy or rebate." *See Silkwood*, 464 U.S. at 248 ("any state law falling within [an exclusively federal] field is preempted"); *cf. Altamont Gas Transmission Co. v. FERC*, 92 F.3d 1239, 1248 (D.C. Cir. 1996) (agency may not "do indirectly what it [may] not do directly"). How the payments are "furnished" is of no significance. The New Jersey statute invades FERC's exclusive field of authority because it both requires generators to sell capacity into the wholesale market and mandates that they receive compensation for each unit of capacity they sell into the PJM market at a price different from the PJM market clearing price. *See New Jersey Board of Pub. Utils. v. FERC*, No. 11-4245, 2014 WL 642943, at *17 (3d Cir. Feb. 20, 2014) ("*NJBPU*") (the price for capacity "is squarely, and indeed exclusively, within FERC's jurisdiction").

There is likewise no merit to appellants' argument that the contracts authorized by the New Jersey statute are "financial" contracts, "contracts for differences," or "hedges" that fall beyond the scope of FERC's exclusive jurisdiction. *See, e.g.*, CPV Br. 9; NJBPU Br. 3; Hess Br. 3. By paying generators for capacity cleared in PJM's capacity auctions, the state-mandated contracts set the terms and conditions of wholesale sales of capacity and thus overstep the jurisdictional boundaries delineated by the Federal Power Act. *See* 16 U.S.C. § 824b. Nor can this intrusion on FERC's domain be excused merely because the state contracts require compliance with the PJM market rules approved by FERC. *See* NJBPU Br. 17; CPV Br. 19; Hess Br. 30–31. As the Supreme Court has made clear, "[w]here Congress occupies an entire field . . . even complementary state regulation is impermissible," and all "state regulation in the area" is foreclosed, "even if it is parallel to federal standards." *Arizona v. United States*, 132 S. Ct. 2492, 2502 (2012).

Finally, appellants are wrong in arguing that because the capacity payments are not "consideration for [electric distribution companies'] purchase of capacity," they should not be deemed to alter the wholesale price for capacity sold through the PJM capacity auctions. CPV Br. 18; *see also id.* at 38; NJBPU Br. 32–33. The Federal Power Act regulates the "rates and charges made, demanded, or received by any public utility for or in connection with . . . [the] sale of electric energy" subject to FERC's jurisdiction — *i.e.*, what public utilities are paid for electricity sold, not what purchasers pay for electricity purchased. 16 U.S.C. § 824d(a). It is irrelevant to the preemption analysis that the state capacity payments are "not consideration for [the electric distribution companies'] *purchase* [of] capacity." CPV Br. 38 (emphasis added). What is relevant — and fatal to appellants' case — is that the state capacity payments are consideration for the generators' *sale* of capacity into the PJM capacity auctions. By changing the wholesale rate, the New Jersey statute invades FERC's exclusive jurisdiction.

2. The New Jersey Statute Impermissibly Conflicts With Federal Law.

The New Jersey statute is also preempted because it interferes with the carefully constructed federal regulatory regime governing PJM's capacity market. *Gibbons v. Ogden*, 22 U.S. (9 Wheat) 1, 211 (1824) (the Supremacy Clause invalidates state laws that "interfere with, or are contrary to," federal law). In setting wholesale rates, FERC is required to ensure that rates are just and reasonable, *see* 16 U.S.C. § 824d, and to balance "difficult (and often competing) objectives" for preserving the reliability and efficiency of the wholesale capacity markets. *Cf. Buckman Co. v. Plaintiffs' Legal Comm.*, 531 U.S. 341, 349 (2000). If it is not struck down, the New Jersey LCAPP statute will upset the delicate balance of competing federal interests struck by FERC. Three points bear emphasis:

First, the New Jersey statute directly conflicts with the market rules set forth in PJM's federal tariff that FERC approved after a multiyear regulatory process involving PJM, market participants, and other stakeholders. *See PJM Interconnection, LLC*, 117 FERC ¶ 61,331 (2006) ("*PJM I*"). Under the FERC-approved rules governing PJM's "reliability pricing model" program, a large utility may opt out of the program if it can demonstrate that it has secured sufficient capacity to meet its customers' needs. *See NJBPU*, 2014 WL 642943, at *5–*6; *PJM Interconnection, LLC*, 115 FERC ¶ 61,079, at PP 70, 110–11 (2006). Even where this option is "not a viable alternative," *NJBPU*, 2014 WL 642943, at *20, utilities are still free to purchase capacity under bilateral contracts entered into outside the "reliability pricing model" construct. Utilities that do not opt out are required to purchase any capacity obligations not met through their own facilities or bilateral contracts through annual auctions conducted by PJM three years in advance of when the capacity is required. *PJM I*, 117 FERC ¶ 61,331, at P 28.

The auction process achieves a delicate balance of regulatory objectives, including ensuring that each generator that sells capacity into the PJM market receives a "single market-clearing price." *Id.* at P 141. PJM clears each auction using a downward sloping demand curve based on the cost of building a new generator and the targeted amount of capacity to be procured, and a supply curve reflecting the capacity offers submitted by generators. *NJBPU*, 2014 WL 642943, at *5 & n.5. The point at which the two curves intersect establishes the auction "clearing price." *Id.* That price is paid to all suppliers that have "cleared" in the auction — that is, all suppliers whose offers were equal to, or below, the clearing price and are therefore obligated to sell capacity to PJM. In approving PJM's auction rules, FERC endorsed the notion that all suppliers with accepted offers would receive the same price for their capacity, and it rejected arguments that payments should instead be based on each supplier's offer price. *PJM I*, 117 FERC ¶ 61,331, at P 141. As FERC explained, "a competitive market with a single, market-clearing price creates incentives for sellers to minimize their costs." *Id.*

The capacity payment scheme established by the New Jersey statute directly interferes with the balance of regulatory objectives achieved by the FERC-approved auction process. An LCAPP generator is required to make capacity sales into the PJM administered capacity auctions but does *not* receive the "single market-clearing price." *Id.* Instead, the price paid to that generator for capacity cleared in the auction is based on the price in its LCAPP agreement. NJBPU Br. 8; Hess Br. 9. That is precisely the result that FERC sought to avoid: In approving PJM's reliability pricing model rules, FERC rejected a proposal calling for "side payments to individual new units," *PJM I*, 117 FERC ¶ 61,331, at P 77, and required that "all winning bidders would be paid a uniform price regardless of their actual cost of supplying electricity." *Id.* at P 141 n.101. New Jersey's decision to provide "side payments" to generators thus "undermine[s] the congressional scheme of uniform rate regulation" by allowing a state "to grant regulated sellers greater relief than they could obtain from [FERC] itself." *Arkansas Louisiana*, 453 U.S. at 579.

The single-clearing price is a core element of the PJM "reliability pricing model" design. FERC recognized that a single clearing price has "the benefit of encouraging all sellers to place bids that reflect their actual marginal opportunity costs," *PJM I*, 117 FERC ¶ 61,331, at P 141 n. 101, resulting in "a competitive market in which the same price is paid to all suppliers based on the marginal cost of the least efficient supplier necessary to serve that market." *Maryland Pub. Serv. Comm'n v. PJM Interconnection, L.L.C.*, 127 FERC ¶ 61,274, at P 15 (2009). In contrast, by making side payments for capacity, the New Jersey statute thwarts FERC's objective to "ensur[e] that generators always have an incentive to submit marginal cost bids." *PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,318, at P 109 (2007); *see also PJM I*, 117 FERC ¶ 61,331, at P 141 n.101 (suppliers are expected to submit capacity offers that "cover[] [their] marginal cost"); *PJM Interconnection, L.L.C.*, 122 FERC ¶ 61,264, at P 56 (2008) (a "competitive seller of capacity is expected to bid its going-forward costs, *i.e.*, the fixed annual operating expenses that would not be incurred if a unit were not a capacity resource for a year").

Second, the New Jersey statute will suppress capacity prices and distort the wholesale markets by introducing "thousands of megawatts of subsidized capacity into the PJM market." *NJBPU*, 2014 WL 642943, at *8. Rather than submitting offers that are based on their marginal costs, the LCAPP generators have radically different incentives because of New Jersey's payment scheme.

In particular, because the LCAPP agreement payments are linked to a generator's capacity clearing in PJM's capacity auctions, the LCAPP generators will be indifferent to the clearing price and will instead submit the lowest possible offers in order to maximize their chances of clearing. *Id.* at *17–*18. That will both "crowd out other capacity that is priced at a higher, cost-based rate" and "result in a lower overall clearing price." *Id.*

at *6. It is thus "undisputed" that New Jersey's "plans to introduce thousands of megawatts of new capacity" into PJM's auctions "would have had an effect on the prices of wholesale electric capacity in interstate commerce." *Id.* at *15; *see also id.* at *17 n.24 (New Jersey does not dispute that the LCAPP "would affect clearing prices"); *id.* at *7–*8; *ISO New England Inc.*, 135 FERC ¶ 61,029, at P 170 (2011) (below-cost offers from facilities receiving "out of market" subsidiaries have "the effect of suppressing capacity prices"); *California Indep. Sys. Operator Corp.*, 141 FERC ¶ 61,069, at P 44 (2012) (expressing concern with reliance on "out-of-market solutions, which tend to artificially depress market prices").

Third, market-wide price suppression appears to be what New Jersey had in mind when it designed its capacity compensation scheme. As the brief filed by the New Jersey Board of Public Utilities makes plain, the state has long been dissatisfied with PJM's capacity markets because "New Jersey ratepayers and other nearby regions [were] paying $245 per MW-day for capacity as compared to $27.73 per MW-day in the rest of PJM," NJBPU Br. 11, and because "the high energy prices [in New Jersey] did not result in the construction of new generation resources." *Id.* at 12. Although New Jersey representatives raised similar complaints in proceedings before FERC, *see PJM I*, 117 FERC ¶ 61,331, at PP 74, 129, the state was evidently dissatisfied with FERC's response and elected to take matters into its own hands by enacting a statute expressly designed to "reduce the cost and volatility of electricity prices in New Jersey." N.J. Stat. Ann. § 48:3-98.2.

II. Appellants' Attempts To Defend The New Jersey Statute Are Unpersuasive.

With no good answers to basic principles of preemption law, appellants attempt to seek refuge in New Jersey's undoubted authority to regulate generation. They also argue that because FERC has taken steps to respond to the distorting effects of the New Jersey LCAPP statute, it has approved the intrusion on federal authority. Both arguments are unpersuasive and wrong.

A. New Jersey's Authority To Regulate Generation Does Not Excuse Its Intrusion On Matters Reserved To FERC's Exclusive Jurisdiction.

In attempting to defend New Jersey's statute, appellants and their supporters repeatedly emphasize New Jersey's authority to regulate the development of generating facilities. *See, e.g.*, NJBPU Br. 19–23; CPV Br. 31–32; Hess Br. 14; States Br. 12–14; NJ Rate Counsel Br. 13–16. But the Federal Power Act's "savings clause" preserving state authority over generating facilities does not require jettisoning traditional preemption principles. *Cf. Geier v. American Honda Motor Co.*, 529 U.S. 861, 869 (2000) (a "saving clause . . . does not bar the ordinary working of conflict pre-emption principles"). Moreover, as noted above, the New Jersey statute goes far beyond encouraging generators to develop new facilities by impermissibly changing the wholesale rate paid for capacity cleared in PJM's capacity auctions. *See* Memo. 34–35 (JA 59–60) (the New Jersey statute "allow[s] new resources to qualify and receive a guaranteed capacity price for a longer period of time" than permitted under PJM's rules).

If New Jersey wanted only to incentivize the construction of new generating facilities, it could have accomplished that objective through contracts that did not reset prices in, or otherwise interfere with, the PJM capacity markets. New Jersey is "free to use" a generation facility even if such facility "fail[s] to clear the auction." *NJBPU*, 2014 WL 642943, at *16. Moreover, PJM's rules allow utilities to opt out of the reliability pricing model program altogether if they so choose, *id.* at *5–*6, and permit utilities to procure capacity outside the auction through bilateral capacity contracts. *PJM I*, 117 FERC ¶ 61,331, at P 13. As briefly discussed in Section III below, there are also other means by which states can lawfully provide incentives for the construction of new generation facilities. These alternatives would have permitted New Jersey to pay for or encourage development of new generating facilities and allowed ratepayers to "receive the benefits" of those payments. NJBPU Br. 31. But New Jersey chose not to utilize those options. Instead, it implemented a capacity compensation scheme that has the direct effect of changing the payments made for capacity that clears through PJM's wholesale capacity auction.

That "additional legislation would be required" before the New Jersey Board of Public Utilities could pursue certain other options, Rate Counsel Br. 6, does not alter the jurisdictional analysis. It only underscores that any restrictions on the state's flexibility are largely of its own making. Indeed, in the late 1990s, when New Jersey chose to restructure its electricity markets and require that its vertically integrated electric utilities divest their electric generating assets, it did so with the understanding that it would "effectively end the system of government regulation of the electricity generation industry" that had previously existed in New Jersey. Memo. 20 (citation omitted) (JA 44); *see* *also* Appellees' Br. 7–8. It also recognized that decisions regarding when and where to build generating facilities would be "informed by economic signals from the wholesale electricity markets that PJM designs and administers" under FERC's supervision. Memo. 21–22 (JA 45–46). The state is "required to shoulder the economic consequences" of its legislative choices. *NJBPU*, 2014 WL 642943, at *16; *cf. id.* at *20 (FERC is not required to provide states with an alternative to participation in PJM's capacity markets).

In pursuing its new capacity compensation scheme, New Jersey is refusing to live with the choices it made and to abide by the rules established by FERC with respect to the wholesale markets. Appellants assert that the state scheme merely "prevent[s] windfalls" by linking the price paid under state law to the PJM auction clearing price. NJBPU Br. 16. But what counts as a "windfall" can often depend on the eye of the regulator. And maintaining long-term, stable energy markets often requires that regulators not interfere by responding to perceived short-term windfalls. *Cf. Morgan Stanley Capital Grp. Inc. v. Public Util. Dist. No. 1 of Snohomish*, 554 U.S. 527 (2008).

In any event, states have no authority to "second-guess[]" the reasonableness of rates regulated by FERC, *Entergy*, 539 U.S. at 50, much less to take action to prevent sellers from receiving prices that the state deems to constitute a "windfall." As the Supreme Court has emphasized, a state cannot use its "undoubted jurisdiction" over retail rates to justify intrusions on FERC's jurisdiction over wholesale rates. *Nantahala*, 476 U.S. at 970*; see also Mississippi Power & Light Co.*, 487 U.S. 354 (state cannot use its jurisdiction over purchasing decisions by local utilities to override rates approved by FERC). The same principle prohibits New Jersey from interfering with FERC's exclusive jurisdiction under the pretense of "regulat[ing] power generation." NJBPU Br. 2.

B. FERC's Efforts To Protect The Capacity Markets From State Interference Do Not Rescue The New Jersey Statute.

Appellants and their supporters argue that FERC's efforts to protect the PJM capacity markets from the impacts of the New Jersey statute and other similar state programs excuse the state's intrusion on FERC's jurisdiction and wash away any conflict with federal law. They argue, for example, that by approving a market mitigation measure known as the "minimum offer price rule," FERC has "recogniz[ed] that" New Jersey's capacity compensation scheme "complement[s], and do[es] not conflict with, the federally-regulated market." Hess Br. 3*; see also* CPV Br. 18 ("FERC has made it quite clear that New Jersey's program is compatible with" PJM's reliability pricing model). These arguments fail for several reasons.

As appellees explain, FERC's approval of the minimum price offer rule is irrelevant to whether New Jersey's efforts to control wholesale power rates are preempted by the Federal Power Act. The rule "has no bearing on the resolution of this case." Appellees' Br. 47.

Moreover, FERC has no authority to redraw the jurisdictional lines established by Congress. *See Kurns v. R.R. Friction Prods. Corp.*, 132 S. Ct. 1261, 1270 (2012) (holding that state requirements are field preempted notwithstanding federal government's contrary argument); *PLIVA, Inc. v. Mensing*, 131 S. Ct. 2567, 2575 (2011) (holding that state requirements conflict with federal law notwithstanding suggestion that state requirements were consistent). FERC cannot abdicate or delegate its ratemaking responsibilities under the Federal Power Act. *See Alabama Elec. Coop., Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982); *Entergy Servs., Inc.*, 120 FERC ¶ 61,020, at P 28 (2007) (FERC's "ratemaking obligations under the FPA cannot be delegated to a state"). Nor can FERC consent to state-mandated side payments for sales of capacity procured through the PJM auction process when those payments set wholesale rates that differ from the just and reasonable rates set through the auction process approved by and on file with FERC. *See, e.g.*, *Louisville & Nashville R.R. Co. v. Maxwell*, 237 U.S. 94, 97 (1915) (a deviation from the filed rate is "not permitted upon any pretext"); *see also Arkansas Louisiana Gas,* 453 U.S. at 582. Indeed, by requiring FERC to exercise regulatory authority through the review and approval of generally applicable tariff provisions, and by prohibiting departures from the rates produced through that process, the Federal Power Act guards against "favoritism" and protects against other forms of undue discrimination. *New York, New Haven & Hartford R.R. Co. v. ICC*, 200 U.S. 361, 391 (1906).

In any event, even if the minimum price offer rule were relevant, appellants mischaracterize FERC's position. FERC made clear when it approved recent modifications to the rule that its intent was "not to pass judgment on state and local policies," *PJM Interconnection, L.L.C. v. PJM Power Providers Grp.*, 137 FERC ¶ 61,145, at P 3 (2011) ("*PJM III*"), but to fulfill its statutory obligations to ensure just and reasonable rates. FERC recognized that "[a] capacity market will not be able to produce the needed investment to serve load and reliability if a subset of suppliers is allowed to bid non-competitively to suppress market clearing prices." *PJM Interconnection, L.L.C. v. PJM Power Providers Grp.*, 135 FERC ¶ 61,022, at P 16 (2011) (*"PJM II"*) (citation omitted). The modifications made to the rule were thus designed to ameliorate impacts on the capacity auction of subsidized bids. But FERC's approval of the minimum offer price rule with modifications does not and cannot constitute approval for states to set wholesale power rates, which are exclusively FERC's responsibility.

Appellants contend that FERC's approval of modifications to the minimum offer price rule means that it has found New Jersey's law to be "compatible" with PJM's capacity markets. CPV Br. 18; *see also id.* at 45; Hess Br. 3; NJ Rate Counsel Br. 3. But FERC has made no such finding. To the contrary, FERC approved the minimum offer price rule in part because of the negative effects of the state law on the PJM capacity market. *Cf. Nantahala*, 476 U.S. at 966; *NJBPU*, 2014 WL 642943, at *20 (FERC forced to act because "states were actually structuring contracts for the development of new resources in a way that would substantially suppress prices, threatening imminent economic harm"). Far from finding that the New Jersey compensation scheme "complement[s]" PJM's capacity markets, Hess Br. 3, FERC emphasized that, although "states are free to promote" policies seeking to encourage new generation, "there is no valid state interest in ensuring that uneconomic offers can submit below-cost offers into the . . . auction." *PJM II*, 135 FERC ¶ 61,022, at P 142. FERC also "took into particular consideration the concern, as expressed by the Pennsylvania Public Utility Commission," that exempting state-sponsored uneconomic entry "could adversely affect other states that wished to rely on prices in the capacity market to incentivize new entry, as opposed to relying on state subsidies." *NJBPU*, 2014 WL 642943, at *19 (citing *PJM II*, 135 FERC ¶ 61,022, at P 142; *PJM III*, 137 FERC ¶ 61,145, at P 96).

While FERC has attempted to protect the PJM capacity market from the distorting effects of unlawful state initiatives, that does not mean that New Jersey has not impermissibly interfered with the federal regulatory scheme. When the market is functioning properly, a new generator can be expected to offer its capacity into the capacity market at a level representing its long-run marginal cost. *See, e.g.*, *PJM I*, 117 FERC ¶ 61,331 at P 141 n.101. Where, as here, a generator is receiving subsidies outside the market, however, this market test fails and PJM must resort to an estimate of the generator's long-run marginal cost. That is an inherently complex, imprecise, and controversial exercise, as illustrated by litigation regarding the application of a minimum offer price rule in a neighboring market. *See generally Hudson Transmission Partners, LLC v. New York Indep. Sys. Operator, Inc.*, 145 FERC ¶ 61,156 (2013); *Astoria Generating Co. L.P. v. New York Indep. Sys. Operator, Inc.*, 140 FERC ¶ 61,189 (2012); *Astoria Generating Co. L.P. v. New York Indep. Sys. Operator, Inc.*, 139 FERC ¶ 61,244 (2012).

It is unrealistic to assume that the minimum offer price rule will be 100 percent effective in correcting for price distortions caused by the New Jersey statute, as shown by the disparity between the cost-based bids generators submitted in response to the LCAPP solicitation and the ostensibly cost-based bids those same generators submitted in PJM's capacity auction. When the LCAPP generators submitted their "bid[s] to construct" that reflected the "sizable costs to construct" their facilities in response to the LCAPP solicitation, CPV Br. 7, 37, they submitted bids as high as $286 per megawatt-day. Memo. 8 (JA 12). Nonetheless, the same generators were able to persuade PJM that their unit-specific costs were supposedly low enough for them to clear when the auction price was only $167 per megawatt-day. *Id.*

Finally, appellants contend that, unless FERC affirmatively acts to invalidate the state capacity payment scheme, there is no basis for finding the New Jersey law to be preempted. But it is understandable that FERC has not on its own initiative rushed to address the legality of state-sponsored initiatives like the New Jersey law. *Cf. Office of Consumers' Counsel, State of Ohio v. FERC*, 842 F.2d 1308, 1311 (D.C. Cir. 1988) (acknowledging that FERC might "wish to avoid deciding an important, unsettled jurisdictional issue in the difficult context of [a] highly complex case"); *ISO New England*, 135 FERC ¶ 61,029, at P 218 (declining to address allegations that Connecticut may have improperly sought to suppress capacity market prices where parties had not sought FERC "enforcement action"). That FERC may be willing to tolerate, and even accommodate, a state's interference with its exclusive jurisdiction is irrelevant. *See Missouri Pac. R. Co. v. Stroud*, 267 U.S. 404, 408 (1925) (there "can be no divided authority over interstate commerce . . . the acts of Congress on that subject are supreme and exclusive"). Congress, not FERC, defines the scope of FERC's jurisdiction under the Federal Power Act.

III. Affirming The Judgment Below Should Not Impede Proper State Efforts To Encourage Generation Development And Reliability.

For all the reasons set forth above, the district court's judgment should be affirmed. It is important to recognize, however, that in striking down the New Jersey statute, this Court need not and should not limit a state's ability in other cases to take appropriate steps to encourage generation development and promote reliability. NJBPU Br. 19; CPV Br. 21. *Amici* EPSA and EEI agree with other *amici curiae* that the Court should be cautious not to affirm the lower court's decision on unnecessarily broad grounds.

As a general matter, EPSA and EEI agree that the Federal Power Act "does not displace the [s]tates' traditional authority to promote the development of new generation resources through procurements and long-term contracts between new generation resources and State public utilities." CT PURA Br. 24. The states also possess jurisdiction to examine the prudence of load-serving utilities' wholesale purchases in appropriate circumstances. *See, e.g.*, *Kentucky W. Va. Gas Co. v. Pa. Pub. Util. Comm'n*, 837 F.2d 600, 608–09 (3d Cir. 1988); *Pike Cnty. Light & Power Co. v. Pa. Pub. Util. Comm'n*, 465 A.2d 735, 738 (Pa. Commw. 1983). As the district court recognized, however, the problem with the New Jersey statute is not that the state has exercised its traditional powers with respect to generation facilities and load-serving utilities' wholesale procurement practices, but that the state has sought to change the wholesale rate by mandating that generators receive additional payments for capacity cleared in PJM's auctions. *See* Memo. 60–61 (JA 84–85).

Properly cabined, a decision affirming the district court's decision will not have "unintended consequences" for lawful state efforts to promote renewable generation resources or long term contracting that does not interfere with FERC's exclusive jurisdiction. AWEA Br. 6. In this regard, EPSA and EEI agree that "the wholesale electricity industry benefits when FERC respects the integrity of contracts." NRG Br. 31. But respect for the integrity of voluntary contracts, embodied in "the venerable *Mobile-Sierra* doctrine," *Morgan Stanley*, 554 U.S. at 548, does not mean that traditional bases for invalidating contracts should be cast aside where (as in this case) the contract interferes with FERC's exclusive ratemaking jurisdiction. Moreover, *Mobile-Sierra* deference does not extend to "involuntary" contracts like the state-mandated LCAPP contracts at issue here. A state simply cannot directly modify the rates received by suppliers for FERC-jurisdictional sales, or require specific behavior that directly affects clearing prices, in contravention of FERC's market design.

CONCLUSION

The Court should affirm the district court's judgment below.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

1. Pursuant to Local Rule 38.3(d), I hereby certify that the attorneys whose names appear on this brief are members of the bar of this court, or have filed an application for admission.

2. This brief complies with the type-volume requirements of Federal Rule of Appellate Procedure 29(d) and Local Rule 29.1 because it contains 6,633 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

3. The brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(f) and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in Century Schoolbook 14-point font.

4. Pursuant to Local Rule 31.1(c), I hereby certify that the text of the electronic brief is identical to the text in the paper copies, and that it has been scanned for viruses using McAfee VirusScan Enterprise + AntiSpyware Enterprise 2013 and no virus was detected.

/s/ Ashley C. Parrish
Ashley C. Parrish

CERTIFICATE OF SERVICE

Pursuant to Rule 25 of the Federal Rules of Appellate Procedure, I hereby certify that I have this 25th day of February 2014, served a copy of the foregoing document electronically through the Court's CM/ECF system on all registered counsel.

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