ORAL ARGUMENT SCHEDULED FOR MARCH 27, 2014

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

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

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

Appeal from Judgment of the United States District Court
for the District of New Jersey, No. 3:11-cv-00745-PGS

REPLY BRIEF OF THE PRESIDENT AND COMMISSIONERS OF THE NEW JERSEY BOARD OF PUBLIC UTILITIES, APPELLANTS

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TABLE OF CONTENTS

PAGE

SUMMARY OF ARGUMENT 1

ARGUMENT

I. NEW JERSEY'S LCAPP IS NOT PREEMPTED BECAUSE IT DOES NOT INTRUDE UPON THE FIELD OF WHOLESALE SALES OF ELECTRIC ENERGY 3

A. The SOCAs Are Not Contracts for a Generator's Sale of Capacity or an EDC's Purchase of Capacity, and They Do Not "Set" a Price for Wholesale Capacity Sales 3

B. By Deciding to Deregulate, New Jersey Did Not Abdicate Its Traditional Authority of Ensuring a Reliable Supply of Power......... 11

II. THE LCAPP DOES NOT CONFLICT WITH FEDERAL LAW 13

A. FERC Through Its MOPR Rulings Has Acknowledged that State Programs Like New Jersey's LCAPP Do Not Undermine the PJM Capacity Market or Otherwise Conflict with FERC Policies Related to the Integrity of the PJM Energy Market 13

B. FERC's New Entry Price Adjustment Orders Do Not Reflect Any Determination That Long-Term Price Guarantees Are Contrary to Federal Policy 16

III. THE LCAPP DOES NOT VIOLATE THE DORMANT COMMERCE CLAUSE 19

A. New Jersey Never Evaluated the Economic and Community Benefits of Out-of-State Projects Because No Such Projects Survived Step One of Selection Process, So Appellee's Claim of Discrimination is Merely Hypothetical 22

B. The Process for Selecting the LCAPP Winning Generators Was Open, Fair, and Competitive, Negating Any Putative Showing of Discrimination 25

C. LCAPP Easily Satisfies the *Pike* Balancing Test and Also Survives Strict Scrutiny 26

CONCLUSION 29

TABLE OF AUTHORITIES

PAGE

Cases

Anniston Mfg. Co. v. Davis,
301 U.S. 337 (1937) 23

Brown-Forman Distillers Corp. v. New York State Liquor Auth.,
476 U.S. 573 (1994) 21

Conn. Dept of Pub. Util. Control v. FERC,
569 F.3d 477 (D.C. Cir. 2009)..7

El Paso Natural Gas Co. v. Neztsosie, 526 U.S. 473 (1999)................................ 19

Freeman v. Corzine, 529 F.3d 146 (3d Cir. 2010)... 23

General Motors Corp. v. Tracy, 519 U.S. 278 (1997).. 23

Harvey & Harvey, Inc. v. County of Chester,
68 F.3d 788 (3d Cir. 1995), overruled on other grounds,
538 F.3d 241 (3d Cir. 2008), 68 F.3d at 802.. 25, 27

Ill. Commerce Comm'n v. FERC,
721 F.3d 764 (7th Cir. 2013).. 18

Lebanon Farms Disposal, Inc. v. County of Lebanon,
538 F.3d 241 (3d Cir. 2008) 21

Maine v. Taylor,
477 U.S. 131 (1986) 21, 27, 28

Minnesota v. Clover Leaf Creamery Co.,
449 U.S. 456 (1981) 21

N.J. Bd of Pub. Utils. v. FERC, No. 11-4245,
2014 WL 6429431 3d Cir. Feb. 20, 2014 .... 11, 14-15

Pacific Gas & Elec. Co. v. State Energy Res. Conservation & Development Commission,
461 U.S. 190 (1983) 7

Pike v. Bruce Church, Inc.,
397 U.S. 137, 142 (1970) 21, 26

Pub. Utils. Comm'n. of R.I. v. Attleboro Steam & Elec. Co.,
273 U.S. 83 (1927) 27

Statutes

16 U.S.C. § 824d(a) 4

26 U.S.C. §§ 43, 48 6

N.J. Stat. Ann. § 48:2-13 10

N.J. Stat. Ann. § 48:3-23 6

N.J. Stat. Ann. § 48:3-51 16

N.J. Stat. Ann. § 48:3-98.3(b)(2) 16

The Electric Discount and Energy Competition Act of 1999, P.L. 1999, c. 23 (N.J. 1999), N.J. Stat. Ann. § 48:3-49 et seq. 11

Other Authorities

Final Decision and Order in the matter of Public Service Electric & Gas Company's Rate Unbundling, Stranded Costs, and Restructuring Filings, Docket Nos. EO97070461, EO9707462, and EO97-9463 (Aug. 24, 1999) 5

Monitoring Analytics, LLC, State of the Market Report: Volume II Detailed Analysis (2012), at p.217, Table 7-8 10

PJM Interconnection, L.L.C., 143 FERC ¶61,083 (April 30, 2013) 13

PJM Interconnection, L.L.C., 128 FERC ¶61,157 (August 14, 2009) 13

San Diego Gas & Electric Co., 97 FERC ¶61,275 (Dec. 19, 2001)..........................6

WSPP Inc., 139 FERC ¶61,061 (2012)...8

SUMMARY OF ARGUMENT

Plaintiff/Appellees' argument is based on a faulty premise: the Standard Offer Capacity Agreements (SOCAs) are not contracts for the sale of capacity or for the purchase of capacity in the PJM market as they suggest. Rather, they are contracts pursuant to which New Jersey ratepayers will pay a direct subsidy to generators that agree to build a power plant and that agree to sell the resulting energy and capacity into the PJM market. While appellees try to obfuscate this distinction, it is in fact a significant one: the SOCAs do not govern the sale of capacity by LCAPP generators into the PJM market, nor do they encompass payments for the purchase of capacity. Like any hedge or swap agreement, the SOCAs have a specified strike price (f) and require the EDCs to pay the LCAPP generators an amount after the capacity market price (p) is determined which is based on the quantity of capacity (Q) sold [($(f - p)Q]. But contrary to appellees' assertions, the quantity of capacity sold simply dictates the "out-of-market" price that must be paid; the SOCAs themselves do not govern the sale of capacity, New Jersey ratepayers are not making payments for capacity, and the SOCAs thus do not "set" a wholesale price for capacity in derogation of the Federal Power Act (FPA).

Appellees likewise cannot credibly dispute the import of FERC's MOPR rulings in which FERC made abundantly clear by promulgating changes impacting

LCAPP generators' ability to participate in the PJM capacity auction that it did not view LCAPP as conflicting with FERC's ability to regulate wholesale capacity markets effectively. As discussed in this Court's recent decision affirming certain of FERC's MOPR orders, FERC expressly explained that so long as the reasonableness of the wholesale, inter-state market is assured, it need not and will not interfere with State efforts to incentivize new capacity entry.

Appellees' commerce clause arguments are also unavailing. First, appellees failed to file a cross-appeal on the dormant commerce clause issue and so are precluded from attacking that ruling now. Second, even if appellees' challenge is considered on the merits, LCAPP does not affect the sort of discrimination cognizable under the Commerce Clause. Appellees do no more than posit that LCAPP "would have" discriminated against out-of-state generators had any of them actually submitted eligible bids. Such hypothetical possibilities do not support a claim of discrimination. Because LCAPP is nondiscriminatory, and because New Jersey has a legitimate and compelling interest in assuring that its citizens have an adequate and reliable electric supply, the statute should be upheld.

ARGUMENT

I. NEW JERSEY'S LCAPP IS NOT PREEMPTED BECAUSE IT DOES NOT INTRUDE UPON THE FIELD OF WHOLESALE SALES OF ELECTRIC ENERGY.

LCAPP, through the SOCAs, does not set a price for wholesale capacity sales by displacing the PJM capacity price, nor are the SOCAs contracts for the sale or purchase of capacity. While payments are premised on clearing the capacity market, that prerequisite simply protects ratepayers by ensuring they get the benefit of their bargain, and the SOCAs are in all material respects independent of PJM market mechanisms. Further, LCAPP poses no obstacle to FERC's implementation of PJM auction-based market mechanisms. Notwithstanding any SOCA payments, only resources that are deemed "economic" may participate in the PJM capacity market. This Court accordingly should reverse the judgment below that LCAPP violates the Supremacy Clause by virtue of field and conflict preemption.

A. The SOCAs Are Not Contracts for a Generator's Sale of Capacity or an EDCs Purchase of Capacity, and They Do Not "Set" a Price for Wholesale Capacity Sales.

The SOCAs are the mechanism by which New Jersey ratepayers will pay a subsidy, or "out-of-market" payment, to LCAPP generators that agree to build a new mid-merit or baseload power plant (for a total of up to 2,000 megawatts) and to sell the energy and capacity from that plant into the PJM market. The SOCAs are structured as "contracts for differences," meaning that the level of payments (and who makes them) depends on the PJM auction clearing price. Pursuant to the SOCAs, the LCAPP generators will bid into the market and (if cleared) will receive the difference between the SOCA price and the auction clearing price. The counter-party to the SOCAs, namely the LSE (here, the four state EDCs, *see infra*), will be allocated their full locational reliability charge, receiving no credits for any capacity sold by the LCAPP generators in the PJM market.[1] *See* JA1088-89. The SOCA reconciliation happens separately from the auction involving the LSE's purchase of capacity and is not part of the LSE's weekly billing/settlement process with PJM. *Id. See also* JA1686-87.

The SOCAs thus are not contracts for the sale of capacity, they do not provide for the physical delivery of capacity, and they do not "set" a price for capacity that is sold by the LCAPP generators into the PJM market.[2] Section 4.2 of the SOCAs explicitly states that "[n]othing in this Agreement shall entitle or obligate Utility to purchase, or take title to or delivery of, capacity, electric energy,

[1] Each LSE that serves load in a PJM zone during the Delivery Year must pay a Locational Reliability Charge, which is the product of the LSE's daily zonal UCAP (unforced capacity, a defined term) times the final zonal capacity price. *See* J-53 [PJM Tariff Attachment DD, at 5.14(e).] Charges are calculated and billed on a periodic basis during the Delivery Year. *See id.*

[2] Whether or not the SOCAs are considered purely financial instruments is not the determinative issue here. What matters for purposes of this appeal is whether the SOCAs "set" a capacity price, or otherwise displace the PJM capacity market price. They do not.

or ancillary services" from the LCAPP generator. JA1687. The SOCAs do peg the amount of the subsidy to the difference between the strike price and the capacity market price, and they do require that the generators sell their capacity, subject to PJM rules, into the PJM market. But these provisions simply protect ratepayers and ensure that they do not pay twice for capacity.

When new generation is built, it is necessary to look at funding over a period of 15 to 20 years. Over this time horizon pricing is a matter of a generator recovering costs and making a reasonable return. Thus, the SOCA strike prices (submitted pursuant to a competitive bidding process) are based on calculations of capital and operational expenses by the LCAPP generators, as well as a reasonable rate of return. This is accomplished by locking in a margin against the capacity price that generators will receive during the contract period. Existing generators effectively have already done this through recovery of their so-called stranded costs.[3]

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[3] The term "stranded costs" represents the investment in infrastructure made by an incumbent utility which, the theory went, might become uneconomic in a competitive environment, and unrecoverable in that environment. In 1999, as part of EDECA, the New Jersey BPU allowed appellee PSE&G to recover generation-related stranded costs (net-of-tax) in the amount of $2.94 billion. *See Final Decision and Order in the matter of Public Service Electric & Gas Company's Rate Unbundling, Stranded Costs, and Restructuring Filings*, Docket Nos. EO97070461, EO9707462, and EO97-9463 (Aug. 24, 1999), 1999 WL 708827 (N.J. B.P.U.), at 75. Ratepayers are still paying those costs, and will continue to do so until December 2015. *Id.* at 68.

Appellees point to FERC's exclusive jurisdiction to assess whether wholesale rates are just and reasonable, citing Section 205(a) of the FPA, 16 U.S.C. § 824d(a), and argue that LCAPP supplants FERC's approved rates for capacity. The problem with this argument is that while FERC has exclusive authority to regulate "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*," *id.* (emphasis added), the SOCAs are not FERC-jurisdictional because they do not set the *rate* charged or received for capacity sales by any public utility. *See San Diego Gas & Electric Co.*, 97 FERC ¶61,275, at 20 (Dec. 19, 2001) (holding that if FERC "lack[s] jurisdiction under FPA § 201(b)(1), then the issue of [FERC's] rate authority under sections 205 and 206 never arises."). To be sure, the amount of the subsidy is linked to the amount of capacity sold, and the price of that capacity, in the PJM market. But that is true of every swap, hedge or contract for differences where the market clearing price is the counter-strike price: there would be no way to quantify the contract value in such case apart from basing it on the *quantity* of energy or capacity sold. The critical distinction here is that the SOCA payment is *not* for the physical delivery of capacity, and New Jersey is not compensating the LCAPP generators *for* their sales into the PJM capacity market, nor are the EDCs paying for capacity.[4] The

[4] New Jersey recognizes that the SOCAs refer to the strike price as the "Standard

only wholesale sales are from the LCAPP generators to PJM, and the price of those wholesale sales will be "set" by the FERC-regulated PJM markets.

To the extent the SOCAs require some physical performance apart from the physical delivery of capacity, those performance requirements are within the State's power to impose under the FPA as non-price aspects of the power sale market. As noted, the SOCAs require LCAPP generators to build a plant and to sell the resulting power into the PJM markets so that ratepayers receive the benefit of their bargain: if the project is never built or, if once built, it fails to produce power or clear the market, then the generator will not receive any SOCA payments. These requirements fall within states' traditional responsibility in the field of regulating electric utilities for "determining questions of need, reliability, cost and other related state concerns." *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission*, 461 U.S. 190, 205 (1983); N.J. Stat. Ann. § 48:3-23 (BPU may require any public utility to furnish safe, adequate and proper service). In *Connecticut Department of Public Utility Control v. FERC*, 569 F.3d 477 (D.C. Cir. 2009), the D.C. Circuit held that "State and municipal authorities retain the right to forbid new entrants from providing

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Offer Capacity Price," but this nomenclature aside, the SOCAs expressly are not for the physical delivery of capacity. *See* JA1687. Nor can the strike price be the market capacity price, as the former is a calculated value based on the LCAPP generators' estimated construction and operational costs, plus a reasonable rate of return. JA1736.

new capacity . . . or to take any other action in their role as regulators of generation facilities without direct interference from [FERC]"—notwithstanding that such actions would "affect the market clearing price for capacity." *Id.* at 481. If states can forbid new entrants from providing new capacity, it logically follows that states can *require* new entrants to provide new capacity, so long as that capacity—if tendered into the PJM market—is tendered at PJM market rates.

Appellees' attempt to distinguish the various state programs that are, in all relevant respects, structured like LCAPP are not persuasive. The point is that, whether or not such a state program "merely *impacts*" (PPL Br. 35) wholesale energy or capacity rates, they are structured like LCAPP in that they provide an out-of-market payment, with the ultimate cost borne by ratepayers, that are net of amounts received by the subsidized generator in the FERC-administered energy markets. As explained in New Jersey's opening brief (NJ Br. 27-28), the PSE&G Solar 4 All program is one such program, which provides for a return on equity of 10% payable over a 20-year period for constructing new solar capacity, in addition to recovery of expenses from ratepayers. These costs are offset by the energy and capacity revenues PSE&G receives, as well as by revenue from the sale of Solar RECs. NJ Br. 28. Appellees' attempt to distinguish this program because it involves a retail utility is a distinction without a difference. The primary point is that PSE&G is receiving a specified payment net of capacity, energy and SREC sales revenues, and it is required to sell into the wholesale market provided transmission is available. In these particulars it is no different than the LCAPP program.

Nor are appellees correct in contending that subsidized renewable energy programs are distinguishable because they merely *impact* wholesale energy rates. To the contrary, LCAPP is exactly like renewable energy and other subsidized clean energy programs to the extent that the introduction of any new capacity into the energy market, by virtue of the law of supply and demand, will have an impact on wholesale energy prices, all other things being equal. Moreover, LCAPP generators—unlike renewables—are subject to new entry mitigation rules (MOPR), ensuring that PJM's capacity market can continue to function as intended, *i.e.*, that capacity prices will not be artificially depressed.[5]

In any event, the LCAPP generators, assuming they build a plant, will introduce approximately 1,340 MW of capacity into the PJM market. This is far less than the amount of wind power introduced into the PJM market. For example, in its State of the Market Report for PJM for calendar year 2012, PJM's independent market monitor reports that approximately 6,500 MW of wind

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[5] Wind and solar power resources, as previously noted, are not subject to MOPR. In addition, PJM in 2009 modified its market rules to allow wind generators to submit negative price offers into PJM energy markets. *See PJM's Negative Offer Implementation,* www.pjm.com/~/media/committees-groups/committees/mic/20090814/20090814-item-07-negative-offer-implementation-examples.ashx (last visited March 4, 2014).

resources were offered to PJM's real-time market in 2012, representing 1.8% of electricity generation in PJM. *See Monitoring Analytics, LLC, State of the Market Report: Volume II Detailed Analysis* (2012), at p.217, Table 7-8, www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2012.shtml (last visited on March 4, 2014).

Furthermore, the subsidies received by wind power have been generous: Wind generators receive a federal production tax credit 2.3 cents for each kilowatt-hour of electricity produced during the first 10 years of operation[6], as well as revenue from selling RECs for each megawatt-hour (MWh) of energy produced pursuant to state-level renewable portfolio standards. Yet while RECS—like the SOCA payments--are a form of out-of-market payment, FERC has found that a REC transaction that is independent of a wholesale electric energy transaction does not affect wholesale energy rates and thus is not within FERC's jurisdiction. *WSPP Inc.*, 139 FERC ¶61,061, at ¶24 (2012). Here, like "unbundled" REC transactions, payments under the SOCAs are independent of any wholesale energy transaction: the SOCAs neither govern payment for the sale of capacity, nor govern payment for the purchase of capacity. *See* Hess Reply Br. 11-15.

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[6] *See* Database of State Incentives for Renewables & Efficiency, Renewable Electricity Production Tax Credit, http://dsireusa.org/incentives/incentive.cfm?Incentive_Code=US13F (last visited March 4, 2014). Pursuant to the American Taxpayer Relief Act, the PTC was extended for wind products that started construction before January 1, 2014.

Implicitly recognizing that their theory of FERC jurisdiction could wipe out various state programs to incent renewables or other types of new, cleaner energy sources, appellees contend that New Jersey and other states can address their energy and reliability concerns by taking a "wide range" of actions (PPL Br. 38), such as pursing FERC's fixed resource requirement (FRR) option. That New Jersey theoretically may utilize other means to incent the construction of new generation facilities is irrelevant, however, to this appeal. Moreover, as this Court recently noted, the primary alternative cited by appellees—the FRR option-- is not a viable alternative for New Jersey, as it is "an all-or-nothing proposition, and appeals as a practical matter only to large utilities that still follow the traditional, vertically-integrated model." *New Jersey Board of Public Utilities v. FERC*, No. 11-4245, -- F.3d---, 2014 WL 642943 (3d Cir. Feb. 20, 2014), at *5.[7]

B. By Deciding to Deregulate, New Jersey Did Not Abdicate Its Traditional Authority of Ensuring a Reliable Supply of Power.

The Electric Discount and Energy Competition Act of 1999 (EDECA), N.J.Stat.Ann. 48:3-49 *et seq.*, deregulated New Jersey's electric industry. Since 1999, the four New Jersey Electric Distribution Companies (EDCs)—Public Service Gas & Electric Company, Atlantic City Electric Company, Jersey Central Power & Light Company, and Rockland Electric Company--have divested

[7] Likewise, returning to a traditional regulated system and re-vertically integrating its utilities in order to construct new generation facilities is not a preferred option. Trial Tr. 2058:15-24 (Roach).

themselves of almost all of their generation assets. But while appellees emphasize New Jersey's decision to deregulate its electric energy, New Jersey has by no means ceded its authority over the supply of electricity: The State retains its traditional authority over generation and implementation of policy initiatives addressing both supply-side and demand-side resources for electricity production. *See* NJ Br. 27-29. In particular, New Jersey, through the BPU, maintains the regulatory authority to compel or incentivize the four EDCs to take actions that foster the environmental, economic and reliability goals of the State. N.J.Stat.Ann. §48:2-13.

Pursuant to this extant authority, New Jersey determined that it needed to expand electric generation resources to improve reliability and to lower costs, consistent with environmental and economic development objectives. It consequently enacted LCAPP to address these objectives following a series of public statements and hearings that raised specific reliability concerns. *See* NJ Br. 11-15. Because no private entity was willing or able to enter into long-term contracts to help finance construction of a new plant, New Jersey ordered the state EDCs to do so, using ratepayer monies to fund the contracts. The risk of no private entity willing or able to enter into long-term contracts was foreseen in the development of the RPM market design, and specifically for this reason states retained the right to act as a counter-party themselves, without being subject to the

MOPR, in order to ensure that needed capacity was built. *See* 117 FERC ¶61,331 (Dec. 22, 2006), at ¶103 n. 75. As explained below, FERC subsequently eliminated the MOPR exemption for state-sponsored generation, but it never determined or in any way opined that state-sponsored generation now was precluded by the FPA or "federal policy."

II. THE LCAPP DOES NOT CONFLICT WITH FEDERAL LAW.

FERC's MOPR Orders ensure that there is no conflict between LCAPP and FERC's regulation of wholesale electricity markets. FERC's NEPA Orders are not to the contrary, and in any event apply only to "the issue of lumpy investments in a small LDA." *See, infra.*

A. FERC Through Its MOPR Rulings Has Acknowledged that State Programs Like New Jersey's LCAPP Do Not Undermine the PJM Capacity Market or Otherwise Conflict with FERC Policies Related to the Integrity of the PJM Energy Market.

FERC is concerned with the integrity of the interstate energy markets. FERC's statutory obligation, to the extent it relies on competitive markets to establish price, is to prevent market power abuse and market manipulation that would impede the proper working of those markets, and to ensure that market-based rates are "just and reasonable." Three days after the LCAPP was enacted, P3[8] filed a complaint with FERC contending that without effective mitigation, state programs intended to support new generation through out-of-market payments to the generator would implicate the price suppression concerns that MOPR was intended to address and undermine the integrity of competitive markets. JA468-69. Accordingly, among other things, P3 urged PJM (and FERC) to eliminate the MOPR's exemption for state-mandated resources. FERC agreed to eliminate the exemption, citing "mounting evidence of risk" that state-subsidized resources could suppress auction prices. JA507. In its subsequent November 17, 2011 Order, FERC reaffirmed that the MOPR should be amended to prevent "subsidized entry supported by one state's or locality's policies" from "disrupting the competitive price signals [the auction] is designed to produce." JA537-38. Numerous parties petitioned for review of FERC's 2011 Orders.

On appeal, this Court rejected New Jersey's argument that elimination of the state-sponsored exemption interfered with state efforts to sponsor new capacity resources, stating:

> New Jersey Petitioners are wrong; what FERC has actually done here is permit states to develop whatever capacity resources they wish, and to use those resources to any extent that they wish, while approving rules that prevent the state's choices from adversely affecting wholesale capacity rates.

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[8] P3 is a nonprofit organization of PJM stakeholders. *See NJBPU v. FERC*, 2014 WL642943, at *9, n.13 (Feb. 20, 2014), and www.p3powergroup.com (last visited March 4, 2014). All incumbent generator plaintiffs/appellees are members of P3.

NJBPU v. FERC, 2014 WL 642943, at*17. And in affirming FERC's decision that a new resource would no longer be subject to mitigation after it cleared one auction (as opposed to multiple auctions) at an offer price near its full cost of entry, even if it was receiving out-of-market subsidies, this Court found reasonable FERC's rationale for its decision. As FERC explained, "even if discriminatory subsidies are being received, if the resource is needed at the MOPR bid then it is a competitive resource and should be permitted to participate in the auction regardless of whether it also receives a subsidy." *Id.* at *28, quoting FERC's April 12, 2011 Order ¶177 (JA518).

Thus, FERC has expressly found that its MOPR Orders prevent a subsidized generator from artificially depressing capacity prices, thereby undermining wholesale energy markets, or otherwise inhibiting rates from being "just and reasonable." Appellees nonetheless argue that FERC's MOPR rulings have no bearing on the conflict preemption question because they only address the prices at which generators may bid into the PJM capacity market, and not the prices or rates they may receive "for or in connection with" capacity sales. Appellees' argument is based on a misconception: as explained above, the SOCAs do not govern the *sale* of capacity into the PJM market, nor do they set the *rates* to be paid for capacity to resources like Hess and CPV. Those rates are determined solely by the PJM market clearing price. And the MOPR Orders in fact do address the FPA's just and reasonable standard, explaining that resources that clear the market at or near their cost, and are therefore deemed economic, are consistent with the FPA's requirements notwithstanding any out-of-market payments they may receive.

B. FERC's New Entry Price Adjustment Orders Do Not Reflect Any Determination That Long-Term Price Guarantees Are Contrary to Federal Policy.

Appellees argue that the LCAPP conflicts with federal law as expressed through FERC's New Entry Price Adjustment (NEPA) Orders. It does not, and FERC's MOPR Orders affirm that it does not.

The NEPA provision allows a new capacity resource to lock-in a "new entry price" for three years under certain conditions. The NEPA provisions in the PJM tariff were:

> [D]esigned to increase incentives for developing capacity in relatively small Locational Deliverability Areas (LDA) with significant supply shortages by enabling capacity resources to receive certain revenue assurances for two years following the initial delivery year. The NEPA reflects the recognition that efficient entry in a small LDA could create a precipitous decline in market clearing prices after the initial delivery year.

April 30, 2013 Order, 143 FERC ¶61,083, at ¶2. The theory is that such a significant lowering of market clearing prices could deter entry that was needed. After considering tariff provisions submitted by PJM revising certain provisions of the Reliability Pricing Model (RPM), including NEPA, FERC refused to relax pre-conditions to qualify for NEPA or to extend the lock-in period. FERC found that the proposed revisions went beyond the intent of the original NEPA provision, which was "intended only to address the issue of lumpy investments in a small LDA." JA441 (emphasis added). *See also* August 14, 2009 Order, 128 FERC ¶61,157, at ¶101(denying re-hearing, and noting NEPA is designed to compensate for the reduction in surplus "attributable to such lumpy investment").

Thus, it was only in this very particular context that FERC opined that new entry and existing capacity resources should receive the same auction clearing prices. But in any event, FERC's NEPA Orders do not set forth any new policy: since the inception of RPM FERC has maintained that there be a single auction clearing price for capacity (absent application of NEPA), and that all classes of capacity (including, more recently, demand response resources) be treated equally insofar as participating in the wholesale energy markets. LCAPP is not in derogation of these policies. As explained herein, the SOCAs do not set a price or rate for capacity that is different from, or that "displaces," the PJM auction clearing price. What the SOCAs do is provide a subsidy to certain new generation resources that New Jersey has determined are necessary for reliability and economic development purposes. LCAPP is not in derogation of FERC policy: FERC in its November 17, 2011 Order explained that the MOPR does not interfere with states' decisions to provide assistance for new capacity entry (*i.e.*, a subsidy) where they believe such expenditures are appropriate for their state, and that FERC seeks "only to ensure the reasonableness of the wholesale inter-state prices determined in the markets PJM administers." JA562. This, FERC contends, it has done through adjustments to the MOPR. Finally, as previously discussed, both the federal government and states treat new wind resources (among others) differently from existing resources by effectively guaranteeing them higher prices by means of the production tax credit and RECs issued pursuant to state renewable portfolio standards. Yet FERC has never contended that subsidies for wind generation undermine or interfere with FERC's wholesale market policies, nor has any court so held.[9]

Appellees lastly contend that New Jersey has created a significant obstacle to the accomplishment of federal regulatory objectives, presumably a market where new and existing resources are always treated the same under all circumstances. First, as the existence of the federal production tax credit, federal and state tax incentives, and various state programs discussed in New Jersey's opening brief exemplify, all resources are not treated the same. Indeed, programs that subsidize

[9] *See Ill. Commerce Comm'n v. FERC*, 721 F.3d 764 (7th Cir. 2013). In that case the court upheld FERC's approval of a plan in the Midwest to apportion costs for new power lines designed to boost reliability and transport megawatts of wind power from remote areas to population hubs around the Great Lakes. While preemption was not an issue in the case, the Court discussed with approval the benefits associated with the promotion of wind power by the transmission projects. *Id.* at 774-75.

renewable generation and demand response resources are encouraged by both federal and state public policy goals. *See* NJ Br. 29.

Second, providing subsidies to certain generation facilities does not create a conflict or interfere with federal regulatory objectives so long as the state does not seek to manipulate wholesale energy prices. The FPA governs regulation of the wholesale electricity market; it does not mandate that all resources must be treated the same where the sale of electric energy at wholesale is not at stake.

In sum, LCAPP does not set wholesale prices for electric capacity; that is done through the FERC-regulated RPM capacity market. Nor does LCAPP, by providing a long-term revenue guarantee, conflict with federal policy. LCAPP falls within traditional State jurisdiction, expressly preserved by the FPA, to promote new supply-side generation, and so should be upheld as valid.

III. THE LCAPP DOES NOT VIOLATE THE DORMANT COMMERCE CLAUSE.

As an initial matter, the Court lacks jurisdiction to consider this argument because the District Court found LCAPP preempted under the Supremacy Clause but valid under the dormant Commerce Clause. Appellants appealed the Supremacy Clause aspect of the District Court's ruling, but appellees did not cross-appeal the dormant Commerce Clause ruling. *See El Paso Natural Gas Co. v. Neztsosie*, 526 U.S. 473, 479 (1999) (absent a cross-appeal, an appellee "may urge in support of a decree any matter appearing in the record, although his argument may involve an attack upon the reasoning of the lower court, but may not attack the decree with a view either to enlarging his own rights thereunder or of lessening the rights of his adversary . . . .") (internal quotations omitted).

But even considered on its merits, appellees' dormant commerce clause argument fails. LCAPP called for a competitive bid process, by which eligible generators would submit bids to the BPU's independent LCAPP agent charged with administering the LCAPP Request for Proposal (RFP) process. The LCAPP agent was responsible for prequalifying eligible generators for participation in the LCAPP "through a showing of environmental, economic, and community benefits, and through reasonable certainty of completion of development, construction and permitting activities necessary to meet the desired in-service date." N.J.Stat.Ann. §48:3-98.3(b)(2). LCAPP defines an "eligible generator" as a developer of a base load or mid-merit generation facility that qualifies as a capacity resource under PJM criteria and that commences construction after LCAPP's effective date, *i.e.* January 28, 2011. N.J.Stat.Ann. §48:3-51.

According to appellees, through its consideration of economic and community benefits, LCAPP favored in-state facilities over out-of-state facilities. Because the statute is facially neutral, appellees base their dormant Commerce Clause claim on this purportedly discriminatory "effect." Appellees are wrong, as the manner utilized by the State to procure generation facilities did not discriminate against out-of-state generators.

The dormant Commerce Clause is generally analyzed using a two-tier approach. Under the first tier, the court must determine whether the law at issue "directly regulates or discriminates against interstate commerce" or if "its effect is to favor in-state economic interests over out-of-state interests." *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573, 579 (1994). Such discriminatory laws will be upheld only if the State shows that it has no other means to advance a legitimate local purpose. *Maine v. Taylor*, 477 U.S. 131, 138 (1986). On the other hand, if a statute has only indirect effects on interstate commerce and regulates evenhandedly, the Court will examine whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the putative local benefits. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). This balancing test "is carried out in light of [federal courts'] hesitation to interfere in internal policy decisions traditionally vested with local governments." *Lebanon Farms Disposal, Inc. v. County of Lebanon*, 538 F.3d 241, 250 (3d Cir. 2008). Generally in light of these considerations, nondiscriminatory statutes survive this balancing test. *See, e.g., Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 465 (1981) (upholding a Minnesota law that prohibited the use of non-recyclable plastic milk containers "[e]ven granting that the out-of-state plastics industry is burdened . . . , [because] this burden is not clearly excessive in light of the substantial state interest in promoting conservation of energy and other natural resources and easing solid waste disposal problems.").

A. New Jersey Never Evaluated the Economic and Community Benefits of Out-of-State Projects Because No Such Projects Survived Step One of the Selection Process, So Appellee's Claim of Discrimination is Merely Hypothetical.

As set forth in his report, in evaluating generator bids the LCAPP agent discerned three eligibility conditions: (1) the generation facility must be a base load or mid-merit facility; (2) it must qualify as a capacity resource under PJM criteria; and (3) it must be a *new* facility that did not begin construction until after January 28, 2011. JA1948. These three criteria are all non-discriminatory and objective. The LCAPP agent rejected a total of 21 out of 34 applications, including some located in New Jersey, because they were tied to existing generation facilities, and hence did not satisfy LCAPP's aim of fostering and incentivizing the development of *new* electric generation facilities. Four projects were eliminated because they were peaking units, rather than base load or mid-merit. JA1958. Application of these neutral criteria left nine proposals, all of which involved projects to be located in New Jersey. JA1959-60. Of these nine projects, six submitted bids. JA1962.

It was at this point in the selection process—when only New Jersey-based projects remained in the bidding pool--that the LCAPP agent evaluated the environmental, economic and community benefits that each proposal would provide. JA1959-60. Appellees essentially argue, then, that *if* an out-of-state generator had submitted an eligible bid, that bid would have been subject to discriminatory criteria. But the Supreme Court has "never deemed a hypothetical possibility of favoritism to constitute discrimination that transgresses constitutional commands." *General Motors Corp. v. Tracy*, 519 U.S. 278, 310-311 (1997); *see also Anniston Manufacturing Co. v. Davis*, 301 U.S. 337, 353 (1937) ("Constitutional questions are not to be decided hypothetically"). "[T]he mere fact that a statutory regime has a discriminatory *potential* is not enough to trigger strict scrutiny." *Freeman v. Corzine*, 529 F.3d 146, 164 (3d Cir. 2010). Because no out-of-state generators submitted a pre-qualifying bid, their claim of discrimination is hypothetical and cannot be used to invalidate LCAPP.

But even assuming a hypothetical out-of-state project bid were deemed eligible, both in-state and out-of-state generators could have demonstrated "environmental, economic, and community benefits" to New Jersey. For example, a new, combined-cycle, natural gas-fired facility located in the PJM footprint would provide environmental benefits to New Jersey citizens by replacing aging coal plants located upwind of New Jersey. Tr. 1310:6-23 (Levitan). In fact, "paradoxically," the environmental benefit could be greater if the plant were located outside the State, because in that case, New Jersey also would lower its exposure to the new plant's emissions. *Id.* Similarly, environmental benefits would result from the reduction of less-clean peaking generation within the State, such as the retirement of PSEG's peaking facilities that elected not to bid into the 2012 base residual auction. JA697; JA755.

Similarly, both in-state and out-of-state generators could have demonstrated economic benefits to New Jersey. All other things equal, a generator located in the Philadelphia area or Delaware would have demonstrated the same economic benefits as a plant located in New Jersey. JA844-45; JA847. Moreover, out-of-state generators could have benefited New Jersey by providing in-state jobs, inducing in-state job creation, and improving New Jersey's income multiplier effect. JA846.

Likewise, both in-state and out-of-state generators could have demonstrated community benefits to New Jersey. The "community benefits" inquiry concerned "the developer's ability to drum up support in the community to achieve the [LCAPP Act's] aggressive [construction] milestones" – in whatever community the facility might be located. Tr. 1313:4-24 (Levitan). The analysis was not limited to New Jersey sites; rather, the benefit being sought for New Jersey ratepayers was the timely construction of a qualifying new generation facility in PJM.

B. The Process for Selecting the LCAPP Winning Generators Was Open, Fair, and Competitive, Negating Any Putative Showing of Discrimination

Even if appellees could make a putative showing of discrimination, the State may rebut that showing "by presenting evidence demonstrating that the designation process was open, fair, and competitive, i.e., determined by objective . . . bid solicitation, selection criteria, evaluation of bidders, . . . statistical evidence or expert testimony, demonstrating that different aspects of the designation process are as neutral to out-of-state interests in practice as they appear on their face." *Harvey & Harvey, Inc. v. County of Chester*, 68 F.3d 788, 802-03 (3d Cir. 1995). Here, the defendants demonstrated that the process for selecting the LCAPP winning generators was open, fair, and competitive, and was done through a neutral, non-discriminatory RFP process. Appellees presented no evidence to rebut this or to show that the State "would have" actually discriminated against out-of-state projects on the basis of environmental, economic or community benefits. Appellees thus cannot assert that they were improperly disqualified or that their disqualification reflects a discriminatory effect.[10]

[10] Appellees rely on a draft of the LCAPP that would have limited the LCAPP solicitation to in-state generators. But the Legislature consciously rejected this and other aspects of the draft. The Court cannot now read into the LCAPP an "intent" to discriminate taken from language in a preliminary draft that was not enacted.

C. LCAPP Easily Satisfies the *Pike* Balancing Test and Also Survives Strict Scrutiny

Given this lack of discriminatory effect, the *Pike v. Bruce Church, Inc.* requires the court to determine "whether the incidental burden imposed on interstate commerce . . . is 'clearly excessive in relation to the putative local benefits.'" 397 U.S. at 142. The District Court correctly held that New Jersey had a legitimate reason—reliability concerns--for seeking development of new generation facilities that would benefit New Jersey citizens. The Court found that reliability issues, the focus of LCAPP, could be resolved only in one of two ways: development of particular transmission facilities or additional generation in or near the location where the reliability issue would occur. JA88. As such, the Court found it reasonable that the State would incent construction in areas where reliability concerns "are in flux" and that the incentive for community benefits to generators in New Jersey thus appeared reasonable. *Id.* The Court further found that appellees had not met their burden to show otherwise. JA88-89.

In this regard, appellees are wrong in asserting that the District Court "misapplied" and "inverted" the legal standard applicable to its Commerce Clause claim by faulting them for not meeting a burden of proof "they did not possess." PPL Br. 56-57. Appellees premise their contention on the District Court's finding that the LCAPP "places a direct burden on interstate commerce." PPL Br. 56; JA84. But that finding was in the context of appellees' Supremacy Clause claims, wherein the Court found that "by establishing the price that LCAPP generators will receive . . . the LCAPP 'places a direct burden upon interstate commerce' within the meaning of *Attleboro* decision.[11] Moreover, as this Court has noted, the burden of showing that a statute discriminates "rests on the party challenging the statute." *Harvey & Harvey, Inc.,* 68 F.3d at 802. So the District Court properly found that appellees bore the burden of showing discrimination, and that they failed to rebut the State's evidence demonstrating that application of the LCAPP selection criteria was reasonable. But LCAPP withstands even the more rigorous strict scrutiny analysis.

In *Maine v. Taylor*, 477 U.S. 131 (1986), the Supreme Court addressed a dormant Commerce Clause challenge to a Maine statute that completely banned the importation of live baitfish. Although the court found the statute discriminated on its face against interstate commerce, it upheld the statute under the "strict scrutiny" standard. The court found the statute served a legitimate purpose because the importation of live baitfish might pose environmental risks, and "Maine has a legitimate interest in guarding against imperfectly understood environmental risks, despite the possibility that they may ultimately prove to be negligible." *Id.* at 148. The dormant Commerce Clause, the Court held, does not

[11] *Pub. Utils. Comm'n of R.I. v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927).

require that Maine "sit idly by and wait" to see whether importation of baitfish actually causes significant damage "before it acts to avoid such consequences." *Id.*

Here, New Jersey took action to implement a program for the legitimate purpose of assuring long-term reliable and adequate electric service after years of public statements—including from appellee PSE&G—about the electric reliability risks facing New Jersey. *See* NJ Br. 14; JA1571. It did so by enacting a statute that called for new electric generation resources within PJM, with local benefits to break any ties among similarly situated qualifying generators. As *Maine v. Taylor* instructs, the dormant Commerce Clause does not preclude New Jersey from pursuing its legitimate concern about reliability risks, even if such risks "may ultimately prove to be negligible." Nor does the dormant Commerce Clause require New Jersey to "sit idly by and wait" for the lights to go out before acting to avoid such consequences. In sum, the addition of approximately 1,340 MW of electric generation capacity through a competitive procurement process open to all bidders in PJM serves the legitimate purpose of assuring reliability for New Jersey residents, and does not discriminate either directly or indirectly against interstate commerce.

CONCLUSION

For these reasons, NJBPU respectfully requests that the judgment of the district court be reversed.

Respectfully submitted,

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COMBINED CERTIFICATIONS

CERTIFICATION OF BAR MEMBERSHIP

I hereby certify that, pursuant to L.A.R. 46.1, I am admitted to and a member in good standing of the Bar of the United States Court of Appeals for the Third Circuit.

CERTIFICATION OF COMPLIANCE WITH WORD COUNT

I hereby certify that this brief complies with the type-volume requirements and limitations of Fed. R. App. P. 32(a). Specifically, this brief contains 6,964 words in 14 point Times New Roman font.

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I hereby certify that, pursuant to L.A.R. 31.0(c), the text of the electronic brief is identical to the text in the paper copies.

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CERTIFICATE OF SERVICE

Pursuant to FED.R.APP.P. 25, 3RD CIR. L.A.R. 25, AND 3RD CIR. MISC.R. 113.4, I hereby certify that on March 5, 2014, I served a copy of the foregoing brief on all counsel in the following manner:

1. All Counsel in these consolidated cases (with the exception of Brian O. Lipman, State of New Jersey, Division of Rate Counsel) are "Filing Users" of this Court's electronic system, and were served, pursuant to 3RD CIR. MISC. R. 113.4, when this brief was filed through the Court's electronic filing system, by the Notice of Docket Activity generated by the Court's electronic filing system.

2. The following counsel was served by United States mail, postage prepaid: Brian O. Lipman, State of New Jersey, Division of Rate Counsel, 140 East Front Street, 4th Floor, P. O. Box 003, Trenton, NJ 08625.

Dated March 5, 2014

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