NO. 17-2445 (Consolidated with 17-2433)

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

ELECTRIC POWER SUPPLY ASSOCIATION, *et al.*,

Plaintiffs–Appellants,

v.

ANTHONY M. STAR, *et al.*,

Defendants–Respondents.

On Appeal from a Final Judgment of the United States District Court for the Northern District of Illinois, No. 17 CV 1164

PLAINTIFFS–APPELLANTS' RESPONSE TO AMICUS BRIEF OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

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INTRODUCTION

The amicus brief filed by the United States and the Federal Energy Regulatory Commission ("FERC Brief") argues that, based on the facts alleged by Respondents-Appellees at oral argument and the semantics of Illinois's ZEC program, this case can be distinguished from *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288 (2016). FERC reasons that because Exelon asserts nuclear plants sell power outside the wholesale market, and because there is no formal requirement that nuclear plants sell at wholesale in order to receive the ZEC subsidy, the ZEC program does not "suffer from the fatal defect" of *Hughes*. (FERC Br. 12-13.)

FERC's arguments are built upon a fundamentally flawed framework. At this stage, the Court is obliged to "accept[] all well-pleaded factual allegations in the complaint as true and draw[] all reasonable inferences in favor of the appellants." *Heng v. Heavner, Beyers & Mihlar, LLC*, 849 F.3d 348, 351 (7th Cir. 2017) (citation omitted). And the Supreme Court has made clear that "[p]reemption is not a matter of semantics," but rather turns on "what the state law in fact does." *Wos v. E.M.A.*, 568 U.S. 627, 636-37 (2013). Under the well-pleaded factual allegations in the Complaint, the ZEC Program *does* suffer from the fatal defect in *Hughes* because (1) the favored nuclear plants cannot receive the ZEC subsidies without selling their output into the wholesale energy market; and (2) those subsidies are tethered to wholesale market prices in the FERC-jurisdictional energy and capacity markets.

ARGUMENT

I. FERC'S ARGUMENTS REST ON FACTUAL PREMISES THAT ARE INCONSISTENT WITH THE COMPLAINT AND DEMONSTRABLY WRONG

The FERC Brief depends on factual assumptions about the Exelon plants' participation in the wholesale energy market that are inconsistent with the complaint and flatly wrong.

First, FERC relies upon Exelon's unfounded assertion at oral argument "that many nuclear plants in the region 'sell largely to retail customers'" (FERC Br. 11 n.3, 15), a position directly contrary to the complaint's allegations that the Exelon plants sell all of their energy into the wholesale market (A.5, A.15, A.25, A.30, A.32, A.56 (Compl. ¶¶ 10, 36, 54, 64, 72; DeRamus Decl. ¶¶ 35-36)).

Second, contrary to those same allegations, FERC suggests that the Exelon plants need not sell into the wholesale energy market because they sometimes enter into bilateral energy contracts rather than selling through the PJM and MISO auctions. (FERC Br. 11, 15, 16.) But bilateral contracts *are* subject to FERC's jurisdiction, *are* wholesale transactions, and can be carried out *only* at a rate deemed just and reasonable by FERC. *See Morgan Stanley Capital Grp. Inc. v. Public Util. Dist. No. 1 of Snohomish Cty.*, 554 U.S. 527, 546-48 (2008). A ZEC subsidy paid in connection with a bilateral, wholesale FERC-jurisdictional contract is no less preempted than a ZEC subsidy paid in connection with a wholesale sale in an ISO auction.

Third, FERC erroneously suggests that Appellants conceded that Exelon's plants operate outside the wholesale market, claiming that the complaint alleged that Quad Cities "failed to clear the PJM *wholesale auction* for three consecutive years." (FERC Br. 11, emphasis added.) Appellants' complaint actually said that Quad Cities "did not clear in the PJM *capacity auction*," *i.e.*, PJM's annual auction to ensure a plant's availability to deliver power three years into the future. (A.25 (Compl. ¶ 55) (emphasis added); see also Appellants' Opening Brief at 6 (discussing distinction between capacity and energy auctions); A.16-17 (Compl. ¶ 38 (same)).) But this has no relevance to the complaint's allegation, in the very next paragraph, that both Quad Cities and Clinton "can only sell the energy they produce into the wholesale market." (A.25-26 (Compl. ¶56).)

The ZEC subsidy is paid for each megawatt hour generated, *i.e.*, for energy, all of which clears in the wholesale energy market. The subsidy is not paid based on the plants' sales in the separate capacity auction. As a result, the ZECs operate to adjust the price received for wholesale sales of energy, just as the Maryland program in *Hughes* operated to adjust the price received for wholesale sales of capacity.

The Illinois law is preempted because the favored plants must engage in "wholesale market participation" to receive the subsidies. *Hughes*, 136 S. Ct. at 1299. Indeed, the Illinois law requires the subsidy recipients to commit to continue to operate for the entire ten-year duration of the ZEC contracts. 20 ILCS 3855/1-75(d-5)(1)(A)(iv). For these plants, a requirement to operate is equivalent to a mandate to sell all of their output into the wholesale energy market, and thus production and sale are part of the same transaction.

FERC concedes that state subsidies can be preempted "even if not identical to the Maryland program at issue in *Hughes*" provided they "have a direct effect on" wholesale rates. (FERC Br. 19.) That is exactly what Appellants alleged here: the ZEC program was set up knowing that the favored Illinois plants would sell their entire output into the wholesale market; it was designed to have the direct effect of subsidizing the rate these plants receive for that output, so that they make enough to cover their costs despite their inability to do so via wholesale revenues (A.3 (Compl. ¶ 5)); and by keeping uneconomic plants in the market, it will directly and substantially distort the wholesale energy and capacity markets (A.4 (Compl. ¶ 8); A.20-23 (Compl. ¶¶ 46-50)). FERC reaches the contrary conclusion only by assuming that Illinois "provides ZECs for generation of electric [sic] that is then sold outside of the auction." (FERC Br. 11.) Because that assumption is directly contradicted by the allegations of the complaint, and to the Illinois legislature's clear purpose in adopting the ZEC program, the Court should hold that the Illinois statute is preempted under the test that FERC itself articulates.

II. FERC'S ARGUMENTS DEPEND ON THE SEMANTICS OF THE ZEC PROGRAM, RATHER THAN WHAT THE PROGRAM ACTUALLY DOES

The FERC Brief argues that even if the practical effect and actual purpose of the ZEC program is to subsidize the wholesale rates received by Exelon's favored plants, there is no preemption under *Hughes* because the Illinois statute does not expressly require that the subsidized power be sold in the wholesale energy markets. FERC's argument ignores the Supreme Court's holding that "[p]reemption is not a matter of semantics," but rather turns on "what the state law in fact does." *Wos v. E.M.A.*, 568 U.S. 627, 636-37 (2013).

FERC's Brief also contradicts the position of the United States in a brief filed in the Supreme Court just two months earlier, on April 9, 2018. The Court had called for the views of the United States in connection with the petition for writ of certiorari in *Virginia Uranium v. Warren*, No. 16-1275. That case involves whether a state law regulating uranium mining is preempted by federal law governing uranium processing ("milling") and storage ("tailings management"). The United States came out strongly in favor of preemption, rejecting the "cramped view" that a state law "may escape preemption so long as the law operates directly and immediately on an antecedent activity … that is subject to state control." (Br. for the United States as Amicus Curiae, *Va. Uranium, Inc v. Warren*, No. 16-1275 (U.S. May 21, 2018), 2018 WL 2292459 at *9.) "A State's purposeful effort to regulate [matters subject to federal jurisdiction] is preempted even if the State attempts to regulate … indirectly, as by [regulating] necessary antecedent activities that fall outside direct federal control." (*Id.* at *13.)

Given this framework, the United States in *Virginia Uranium* chastised the respondents for "placing dispositive weight on the fact that the [state] statute does not *expressly* 'prohibit[] or otherwise regulate[] milling facilities or tailings storage,'" but addressed only the mining of uranium. (*Id.* at *17, emphasis added.) The United States explained that "[o]nce uranium ore is mined, milling and tailings management are the next steps," and the petitioners "had adequately alleged that respondents banned 'the antecedent mining of uranium ore' *for the purpose*" of banning milling and tailing. (*Id.*)

Moreover, the United States recognized that at the stage of a "motion to dismiss, the courts should take as true petitioners' allegation that the [state's] moratorium was motivated by radiological-safety concerns." (*Id.* at *23.) And "if [the state's] mining moratorium was intended to address radiological-safety concerns purportedly raised by subsequent milling and tailings management activities—activities that [federal government] does regulate—the State cannot escape preemption simply by imposing its prohibition one step earlier in the production process," where the federal government does not regulate. (*Id.* at *16.) Thus, the United States explained, the petitioners' claim of preemption should have survived the state's motion to dismiss.

That United States brief unequivocally supports Appellants' position here. As in *Virginia Uranium*, the state has nominally addressed an antecedent step (energy generation here, mining there) when in reality its purpose and effect is to target the inevitable following step (wholesale energy auctions here, milling and tailing storage there). As in *Virginia Uranium*, Appellants adequately pleaded that purpose and effect, and as in *Virginia Uranium*, Illinois and Exelon moved to dismiss by "placing dispositive weight on the fact that the [state] statute does not expressly" subsidize wholesale rates. *Id.* at *17.

The United States has taken exactly the opposite position here that it has in *Virginia Uranium*.

The United States is right as to preemption law in *Virginia Uranium*, and it is wrong here. Indeed, the FERC Brief's silence is telling. Appellants laid out in detail a well-established line of cases holding that, for preemption analysis, a law's actual purpose and effect control, rather than its semantics. (*See* Opening Brief at 46-50; Reply Brief at 32, 37 (citing *Wos*; *Nat'l Meat Ass'n v. Harris*, 565 U.S. 452, 462-64 (2012); *N. Nat. Gas Co. v. State Corp. Comm'n of Kan.*, 372 U.S. 84 (1963); and other cases.) But FERC does not even cite, let alone distinguish, these cases.[1]

Instead, just like the respondents whom the United States chastised two months ago in *Virginia Uranium*, FERC insists today that there can be no preemption here because the "Illinois statute 'does not expressly mandate participation in the auctions as a condition of

[1] FERC suggests Appellants are "[e]quating private action with state regulation." (FERC Br. 13.) Not so. The relevant point of analysis is the state regulation's purpose and effect as felt in the *real world*, where the *actual behavior* of private actors is relevant. If FERC's argument held, the Solicitor General's position in *Virginia Uranium* would be wrong, as uranium miners could, as a theoretical matter, mine uranium and then put it back in the ground, rather than milling it and storing the tailings.

receiving the ZEC.'" (FERC Br. 11.) In FERC's view, the absence of "this formal legal requirement" is enough to "settle the preemption question," notwithstanding any "[b]usiness realities and market forces." (*Id.* 12.) Perhaps there are policy reasons why the United States would articulate one view of preemption in the *Virginia Uranium* case and then assert the complete opposite view in this case. But the government's policy positions cannot alter the Federal Power Act or the mode of preemption analysis the Supreme Court has established.

Because FERC's Brief rests on a fundamentally flawed legal framework—as well as on fundamentally wrong factual allegations, as explained above—this Court should not adopt its analysis or conclusions.

III. THE COURT SHOULD BE TROUBLED, NOT COMFORTED, BY FERC'S REPEATED INDICATIONS THAT IT MAY NEED TO CHANGE FEDERAL REGULATIONS TO "AMELIORATE … DETRIMENTAL EFFECTS" OF THE ZEC PROGRAM

FERC concedes that it may be forced to "correct[]" or "revise" federal "wholesale market rules to deal with the effects of state subsidies, including ZECs." (FERC Br. at 6, 21.) Yet rather than recognizing that this is a strong indication that the ZEC program is preempted, FERC argues the opposite, trying to comfort the Court with the promise that FERC may be able "to ameliorate, as needed, detrimental effects [of the ZEC program] on markets within [FERC's] jurisdiction." (*Id.* 7.) "If the Illinois program … impairs the wholesale markets subject to FERC jurisdiction, the Commission thus has the means and the authority to confront those effects. The Commission is now considering the impacts on wholesale markets of these sorts of programs." (*Id.* 8.) FERC submits that when a state subsidy such as the ZEC program "impair[s] FERC-jurisdictional wholesale capacity[] markets, the solution lies with the Commission, not with courts." (*Id.* 20.)

That analysis is exactly backwards. "The fact that FERC [is] forced to mitigate the … distorting effects … tends to confirm rather than refute the existence of a conflict." *PPL EnergyPlus, LLC v. Nazarian*, 753 F.3d 467, 479 (4th Cir. 2014), *aff'd on other grounds sub nom. Hughes*, 136 S. Ct. 1288. The same is true for field preemption: In *Hughes*, the Court noted that although FERC was able to "accommodate[] [Maryland's] program" by adjusting its own regulations, "[e]ven assuming that this change has prevented Maryland's program from distorting" the market, a state cannot "require FERC to accommodate [its] intrusion" into an exclusively federal domain. 136 S. Ct. at 1298 n.11.

Moreover, even if FERC could mitigate the adverse effects of the ZEC Program on "wholesale *capacity* markets" (FERC Br. 20, emphasis added), which it has not shown it can do, FERC identifies no mechanism to mitigate the effects on wholesale *energy* markets into which the Exelon plants sell all the electricity they generate.

IV. THE REC PROGRAMS DISCUSSED BY FERC ARE MARKEDLY DIFFERENT FROM THE ZEC PROGRAM

The FERC Brief discusses various state initiatives other than the ZEC program—primarily REC programs—that FERC has upheld. (FERC Br. 22-27.) Appellants have explained how these REC programs are different, and how their differences underscore Illinois' effort to prop up the Quad Cities and Clinton plants' performance in wholesale electricity auctions. For instance, unlike RECs, ZECs are available only to generators selling into wholesale markets. (Reply Br. 40.) RECs are traded in competitive markets with prices set by supply and demand; ZECs are not traded at all but instead are set administratively as a means of keeping specific in-state generators afloat. (*Id.* 40-41.) Whereas RECs operate to incentivize renewable energy production by the most efficient producers, ZECs are awarded to hand-picked *inefficient* producers, to keep them from being underbid by more efficient ones. (*Id.* 41-42.) FERC ignores these key distinctions.

FERC suggests that clean energy credits, no matter how designed, "do not directly affect wholesale energy rates and are not 'in connection with' sales of electricity at wholesale." (FERC Br. 23.) But in *WSPP Inc.*, 139 FERC ¶ 61,061 (2012), FERC said that determining whether a REC is preempted would depend on whether they are structured so that they "directly affect the rate or are closely related to the rate," or instead affect wholesale rates only "indirectly." *Id.* (citing *Cal. Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395, 403 (D.C. Cir. 2004)). FERC concluded that the specific REC programs described in that proceeding were not preempted, but resisted a blanket conclusion that all RECs were permissible.

Even FERC concedes that an otherwise permissible renewable energy credit can be subject to FERC jurisdiction "if the wholesale energy sale and REC sale take place as part of the same transaction." (FERC Br. 23); *see WSPP Inc.* ("parties cannot avoid Commission jurisdiction by simply separating a bundled []transaction"). Because the complaint alleges that ZECs are inseparable from the requirement to clear in the FERC market, under FERC's own test, the dismissal of the complaint should be reversed and the case remanded for further factual development.

CONCLUSION

The Court should not accept the FERC Brief's preemption analysis and should reverse the district court.

Dated: June 11, 2018

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

1. This brief complies with word limit set by the Court's order of June 1, 2018, because, excluding the parts of the document exempted by Fed. R. App. P. 32(f), this document contains 2,597 words, as determined by Microsoft Word 2010.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because this document has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Century Schoolbook font.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on June 11, 2018, I caused the foregoing to be filed electronically with the Clerk of the Court using the CM/ECF system, which will send a Notice of Electronic Filing to all counsel of record.

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