Nos. 14-614, 14-623

IN THE

Supreme Court of the United States

W. KEVIN HUGHES, ET AL., *Petitioners,*

v.

PPL ENERGYPLUS, LLC, ET AL., *Respondents.*

CPV MARYLAND, LLC, *Petitioner,*

v.

PPL ENERGYPLUS, LLC, ET AL., *Respondents.*

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF OF *AMICI CURIAE* AMERICAN PUBLIC POWER ASSOCIATION AND NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICI CURIAE*

The American Public Power Association and the National Rural Electric Cooperative Association write in support of Petitioners W. Kevin Hughes, *et al.* in No. 14-614 (Maryland Petitioners) and Petitioner CPV Maryland, LLC, in No. 14-623 (CPV).[1] The Associations appeared before the court of appeals below as *amici* supporting Appellants and urging reversal of the district court.

The American Public Power Association (APPA) represents the Nation's more than 2,000 not-for-profit, publicly owned electric utilities, which serve over 48 million customers, in every state except Hawaii, and provide over 15 percent of all kilowatt-hour sales of electricity to ultimate customers. APPA's utility members are load-serving entities, with the primary goal of providing customers in the communities they serve with reliable electric power and energy at the lowest reasonable cost, consistent with good environmental stewardship. This orientation aligns the interests of APPA's members with the long-term interests of the residents and businesses in their communities.

The National Rural Electric Cooperative Association (NRECA) represents the Nation's more than 900 not-for-profit, member-owned rural electric utilities, which provide electricity to approximately 42

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[1] All parties have consented to the filing of this brief. In accordance with Rule 37.6, no counsel for any party has authored this brief in whole or in part, and no person or entity other than the *amici* has made a monetary contribution to the preparation or submission of this brief.

million consumers in 47 states, or 13 percent of the Nation's population. Rural electric cooperatives account for approximately 11 percent of all kilowatt-hour sales of electricity in the Nation. NRECA's members also include approximately 65 generation and transmission (G&T) cooperatives, which supply wholesale power to their distribution cooperative owner-members. Both distribution and G&T cooperatives were formed to provide reliable electric service to their owner-members at the lowest reasonable cost.

Both Associations' utility members participate in wholesale power markets in regions of the Nation where "Regional Transmission Organizations" (RTOs), including the RTO discussed in this case, PJM Interconnection, L.L.C. (PJM), operate the electric transmission grid. Since the advent of RTOs fifteen years ago, the Associations' members in RTO regions have continued to exercise their business judgment to obtain electric generation capacity and electric energy from sources that include (a) generation facilities they purchase or build; (b) purchases under long-term and short-term bilateral wholesale contracts; and (c) purchases from RTO-run markets. In doing so, the Associations' member utilities frequently procure generation resources and related services in the bilateral capacity products markets whose role the decision below profoundly misunderstood. The Associations' interest in this case is to ensure that their members continue to be able to obtain the mix of generating capacity resources that, in their judgment, best enables them to meet their environmental and other regulatory obligations and provide safe, adequate and reliable electric service at the lowest reasonable cost.

In this case, the Maryland Public Service Commission (Maryland Commission) sought to exercise its state law mandate "to assure 'safe, adequate, reasonable and proper service for any class of public service company'" by directing retail electric utilities subject to its supervision to enter into a contract with Petitioner CPV Maryland, LLC (14-614 Pet. App. 29a-61a). In invalidating that action, the decision below misapplies both field preemption and conflict preemption principles based on a mistaken view that centralized capacity[2] auctions conducted by RTOs are the only operative price-setting mechanism for capacity and related products and services. Central to the Fourth Circuit's misapplication of preemption principles is an equally mistaken premise that the Federal Energy Regulatory Commission (FERC), rather than the process of contracting between or among participants in wholesale markets, "sets" wholesale power rates.

The Maryland Commission's directive operated on its retail electric utilities in their capacity as *customers* in a wholesale marketplace based on bilateral contracting – the marketplace overlooked completely by the Fourth Circuit's decision. Actions taken by retail utilities as wholesale customers represent neither state "regulation" of wholesale

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[2] "'Capacity' . . . is a standby commitment made by a capacity resource to either produce electric energy or to consume less electric energy at a time in the future when called upon by PJM to do so." (14-614 Pet. App. 86a-87a). "In a capacity market, in contrast to a wholesale energy market, an electricity provider purchases from a generator an option to buy a quantity of energy, rather than purchasing the energy itself." *NRG Power Mktg., LLC v. Me. PUC*, 558 U.S. 165, 168 (2010).

markets, nor interference with the price setting function of the centralized capacity auction. As the Maryland Petitioners point out (Br. at 31-33), the Fourth Circuit's decision upsets the balanced framework of federal and state regulation embodied in the Federal Power Act (16 U.S.C. §§ 791a – 828c (the FPA)), to the prejudice of both federal and state regulatory interests. Ultimately, the Fourth Circuit's decision prejudices the ability of *customers* in wholesale electricity markets – whether they are investor-owned utilities subject to state regulation, or consumer-owned utilities (municipal or cooperative) such as members of the Associations – to respond and react to market forces while fulfilling the need of their retail consumers for safe, adequate, reliable and economic power supply. Indeed, the only beneficiaries of the decision below are incumbent merchant generators participating in RTO-run centralized capacity auctions. The misapplication of preemption principles in the decision below affords those incumbent merchant generators insulation from the force of possible competitive entry. If left in place, the decision below will substantially disrupt the sound functioning of the Nation's wholesale electric power markets, at least in those parts of the eastern United States served by RTOs, by disabling important functions reserved to state regulators under the FPA concerning the development of electric generation resources. For this reason, if the decision below is not overturned by this Court, it is likely to impede the orderly development of needed electric infrastructure at a reasonable cost.

The Fourth Circuit's decision holds that the FPA preempts a directive of the Maryland Public Service Commission that Electric Distribution

Companies (EDCs) engaged in providing retail "standard offer service" within the State of Maryland, as part of their standard offer supply obligations,[3] enter into a twenty-year Contract for Differences (CfD) relating to generating capacity to be sold into an annual centralized capacity auction conducted by PJM. The decision below is at odds with decisions of this Court concerning both field and conflict preemption in federal regulatory regimes, such as the FPA, that explicitly reserve roles for state regulatory authority. In such parallel regulatory regimes, while "state regulation will be displaced to the extent that it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress, . . . it is also true that a federal agency may preempt state law only when and if it is acting within the scope of its congressionally delegated authority." *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986) (internal citation omitted). *See also Nw. Cent. Pipeline Co. v. Kan. Corp. Comm'n*, 489 U.S. 493, 512 (1989) (courts should "avoid encroachment on the powers Congress intended to reserve to the States . . . 'by an extravagant mode of interpretation . . . .'"). Nothing in the FPA even suggests that FERC's authorization of a centralized capacity auction displaces the ability of utilities, including both statutory public utilities and the members of the

[3] "Standard Offer Service" is retail electric service that electric utilities engaged in the distribution of electricity at retail within the State of Maryland are obligated to obtain and provide on behalf of their customers who do not choose a different, competitive electricity supplier. (14-614 Pet. App. 106a-107a). The specific utility obligations associated with standard offer service are set forth in Md. Code, Pub. Utils. Art., § 7-510(c).

Associations, to purchase capacity and related products and services where they choose. The decision below misapplies this Court's precedent on field preemption due, in part, to its failure to understand prior decisions of this Court explaining the operation of the regulatory authority granted by FPA Sections 205 and 206, 16 U.S.C. §§ 824d, 824e, as to who "sets" wholesale electric power rates under the FPA. Specifically, rates are set by public utilities, not by the FERC, which only reviews rates set by public utilities to ensure that those rates meet the FPA's "just and reasonable" standard. *Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527, 533-534 (2008); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 352-353 (1956); *United Gas Pipeline Co. v. Mobile Gas Service Co.*, 350 U.S. 332, 341 (1956).

SUMMARY OF ARGUMENT

The decision below rests on a simplistic and inaccurate view of how centralized capacity auctions, like the PJM Reliability Pricing Model (RPM) at issue in this case, actually operate. The Fourth Circuit's conclusion that the Maryland Public Service Commission's order (14-614 Pet. at 29a-61a) "is field preempted because it functionally sets the rate that CPV receives for its sales in the PJM auction,"[4] and its conflict preemption conclusion,[5] both misunderstand the relationship between generating resource procurement under long-term contracts and the functioning of RTO-operated centralized capacity auctions. The FERC itself has long held that

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[4] 14-614 Pet. App. 19a–24a.

[5] *Id.* at 24a–28a.

centralized capacity auctions are intended to operate in tandem with robust contractual markets, precisely because it is the contractual markets that actually support the addition of needed energy infrastructure with long-term and predictable contract revenues. The preemption finding below is wrong because the centralized capacity auction price on which the court of appeals concentrated its attention, and the contractual capacity price set by Petitioner CPV for the sale of capacity from its proposed new generating unit to Maryland's distribution utilities under the Maryland Public Service Commission order found preempted below, are intended by the FPA, and by the FERC in practice, to coexist and fulfill distinct roles in promoting generation adequacy and reliability within the PJM RTO.

Contrary to the conclusions of the court of appeals, the FERC has consistently acknowledged that long-term contracting by load-serving entities concerning generating capacity, like that directed by the Maryland Commission in the order challenged below, operates as a component of a broader wholesale marketplace of which PJM's centralized capacity auction is also a part. The Maryland Commission order challenged in the proceedings below simply directed a contractual response by Maryland's retail electric utilities to "price signals" provided both by PJM's centralized capacity auction, and by the long-term bilateral wholesale market, to which stimuli the retail utilities were otherwise indifferent because PJM capacity charges are simply passed through to retail customers. The Maryland Commission's directive to the retail electric utilities it regulates did precisely what the FERC contemplated in its original order approving the PJM centralized capacity auction:

it sought to "use this information [from the PJM auction] to manage their risk more effectively . . . through bilateral contracting . . . ." *PJM Interconnection,* L.L.C, 115 FERC ¶ 61,079 at P 70 (2006).

In so doing, the Maryland Commission operated within the jurisdiction reserved to it under Section 201(b)(1) of the FPA, 16 U.S.C. § 824(b)(1). As the FERC itself has explained, "wholesale ratemaking does not, as a general matter, determine whether a purchaser has chosen prudently among available supply options," and "[i]n most circumstances 'a state commission may legitimately inquire whether the retailer prudently chose to pay the FERC-approved wholesale rate of one source, as opposed to the lower rate of another source.'"[6] The Maryland Commission order challenged in the proceedings below did no more than direct the retail electric utilities subject to its jurisdiction to enter into specific contracts in order to protect the interests of retail electric customers by promoting the development of local generation within the State of Maryland. This directive to choose

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[6] *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, *order on reh'g*, Order No. 697-A, FERC Stats. & Regs. ¶ 31,268 at PP 415-416 & n. 567, *clarified*, 124 FERC ¶ 61,055, *order on reh'g*, Order No. 697-B, FERC Stats. & Regs. ¶ 31,285 (2008), *order on reh'g*, Order No. 697-C, FERC Stats. & Regs. ¶ 31,291 (2009), *order on reh'g*, Order No. 697-D, FERC Stats. & Regs. ¶ 31,305 (2010), *rev. denied sub nom. Mont. Consumer Counsel v. FERC*, 659 F.3d 910 (9th Cir. 2011), *cert. denied*, ___ U.S. ___, 133 S. Ct. 26, 183 L.Ed.2d 676 (2012), *quoting Pike County Lt. & Pwr. Co. v. Pa. Pub. Util. Comm'n*, 465 A.2d 735, 738 (Pa. 1983).

"prudently among available supply options" falls well on the state jurisdictional side of the "bright line easily ascertained, between state and federal jurisdiction"[7] that Congress drew in Section 201(b)(1) of the FPA.

In holding that the contracts into which the Maryland Commission required the State's retail electric utilities to enter were preempted by the FERC's approval of the auction mechanisms in PJM's centralized capacity auction, the court of appeals conflated two separate rate-setting processes, each of which has a distinct and well-recognized role in the relevant wholesale electric power market. As the FERC observed in approving the PJM centralized capacity auction construct, electric utilities serving retail customers "may either (a) build their own needed capacity or create an incentive for the construction of new capacity by entering into long-term bilateral agreements, (b) refrain from entering into bilaterals and pay the (presumably higher) prices set by the demand curve, or (c) develop transmission or demand response solutions to capacity problems." *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 at P 172 (2006). The court of appeals' conclusion that the Maryland Commission's order "is preempted because it functionally sets the rate that CPV receives for its sales in the PJM auction" (Pet. App. 19a) mistakenly assumes that the FPA permits only a single price for the sale of generating capacity in PJM, instead of affording retail electric utilities numerous choices of product, service and pricing among the three broad options identified by the FERC.

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[7] *So. Cal. Edison Co. v. FPC*, 376 U.S. 205, 215 (1964).

As part of this premise, the decision below also supposes that the FERC sets wholesale rates (*id.*). This element of the decision parts company with a long line of decisions of this Court holding that the power conferred on the FERC by the FPA "is simply the power to review rates and contracts made in the first instance by. . . [utility] companies and, if they are determined to be unlawful, to remedy them."[8] Prior to the decision below, it had long been understood that:

> Sections 205 and 206(a) 'are simply parts of a single statutory scheme under which all rates are established initially by the (utilities), by contract or otherwise, and all rates are subject to being modified by the Commission upon a finding that they are unlawful. The Act merely defines the review powers of the Commission and imposes such duties on (utilities) as are necessary to effectuate those powers; it purports neither to grant nor to define the initial rate-setting powers of (electric utilities).'[9]

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[8] *United Gas Pipeline Co. v. Mobile Gas Service Co.*, 350 U.S. 332, 341 (1956), cited in *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 352-353 (1956) (". . . we construed the Natural Gas Act as not authorizing unilateral contract changes, and that interpretation is equally applicable to the Federal Power Act. Accordingly, for the reasons there given, we conclude that neither PG&E's filing of the new rate nor the Commission's finding that the new rate was not unlawful was effective to change PG&E's contract with Sierra").

[9] *Papago Tribal Utilities Authority v. FERC*, 610 F.2d 914, 924 (D.C. Cir. 1980), *quoting United Gas Pipeline Co. v. Mobile Gas Service Co.*, *supra*, 350 U.S. at 341.

Under these and other authorities discussed *infra*, the Fourth Circuit's reductive application of *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) – "If states are required to give full effect to FERC-mandated wholesale rates on the demand side of the equation, it stands to reason that they are also required to do so on the supply side" (753 F.3d at 476) – overlooks the FERC's regulation of the contractual markets for capacity products and services that operate outside of the PJM centralized capacity auction, and narrows the FERC's regulatory role to supervision of the PJM centralized capacity auction. Even in that limited context, it is the bid of the last clearing auction participant – not the FERC – that sets the price. More importantly, in the contractual marketplace for capacity and related products and services that operates independently of PJM's centralized capacity auction, prices are set in the first instance by contracting utilities, subject to regulation of the selling party's rates by the FERC. The FERC does not "set" the rates in the contractual marketplace, either. Indeed, in the 59 years since it decided *Sierra Pacific Power Co.*, this Court's explanation of the paramount importance of contracts in the Nation's electric power industry has become increasingly critical to the functioning of that industry. The decision below departs from this settled understanding of the operation of the FPA. That departure threatens the operation of wholesale markets based on bilateral contracting, in which buyers and sellers operating under FERC-approved tariffs are able to negotiate custom agreements that permit each contracting party to address its respective commercial needs. These bilateral wholesale markets are where retail electric utilities (whether investor- or consumer-owned) ensure that they not only have enough resources, but the right resources in terms of energy, fuel diversity, grid support and the host of other considerations that factor into meeting the obligations incumbent on the supply of electricity at retail. The Fourth Circuit's decision thus undermines the stability of a bedrock principle on which the operation of the electric power industry depends.

ARGUMENT

"PJM Interconnection ('PJM') is the RTO that manages the regional transmission system spanning from New Jersey west to Chicago and south to North Carolina." *N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d 74, 82 (3d Cir. 2014). It is a regulated public utility under the FPA. *Pennsylvania-New Jersey-Maryland Interconnection*, 103 FERC ¶ 61,170, PP 16-21 (2003).

The FERC regulates two parallel markets for generating capacity within the PJM region. One of those markets is the centralized capacity auction operated by PJM, which is known as the Reliability Pricing Model or "RPM." The other marketplace, which predates RPM but continues to operate alongside it, is based on bilateral contracting between load-serving utilities and generation owners for the purchase and sale of entitlements in generating capacity and related transactions. Together, the two markets comprise a means for electric utilities with retail supply obligations to make arrangements to satisfy regional resource adequacy requirements,[10]

[10] As the FERC summarized PJM's earlier resource adequacy arrangement, "each [load-serving entity] must procure capacity resources equal to a fixed percentage above its peak load to ensure a sufficient amount of capacity to meet the forecasted

and to acquire safe, economical and reliable power supply resources. The centralized capacity auctions set a price for generating capacity supplied to load-serving participants that have not otherwise supplied their allocated share of applicable regional capacity requirements.

From a long-term reliability perspective, the longstanding bilateral market is far more important, because it actually provides both the supply choices required by wholesale customers, and the long-term, stable financial basis for the capitalization required to support the construction of the overwhelming majority of new generating resources. *Amicus* APPA has monitored generating facility construction trends for the past several years, publishing a series of reports, the latest of which is titled *Capacity Markets Do NOT Incent New Electric Generation.*[11] Finding a continuing trend in publicly reported data on power plant construction, APPA observed that, for new generating capacity entering service in the United States during 2014:

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load plus reserves adequate to provide for the unavailability of capacity resources, load forecasting uncertainty, and planned and maintenance outages." *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 at P 9 (2006).

[11] APPA's 2015 *Capacity Markets Do NOT Incent New Electric Generation* report can be found on-line at http://www.publicpower.org/files/PDFs/94%202015%20Power%20Plant%20Study%20Update%20Final.pdf (last viewed December 14, 2015). Earlier versions of this analysis issued in 2012 and 2014 were titled, *Power Plants Are Not Built on Spec* and *Power Plants Are Not Built on Spec: 2014 Update*, and reached similar conclusions.

- Over half (52 percent) of the capacity was built under purchased power agreements for the sale of the power (29.7 percent were with a utility; 17.6 percent with a financial entity; 2.0 percent under contracts for steam or renewable energy credits; and 2.7 percent with an end-use customer or non-utility retail supplier).

- Another 43.1 percent was constructed under ownership by a utility (42.1 percent) or customer (1 percent).

- At most, 4.8 percent was built solely for sales into RTO markets (*i.e.*, plants for which no information was available indicating long-term sales or financial arrangements were assumed to be built for market sales).

In concluding that activity in the bilateral contractual market for generating capacity is somehow subordinate to the outcome of FERC-supervised centralized capacity auctions, the court of appeals' decision sows doubts that will likely impede wholesale customer choice, the wholesale competition needed to constrain pricing and just and reasonable levels, and the development of needed infrastructure for a considerable period. Investors are obviously diffident about committing the hundreds of millions, or even billions, of dollars needed to build a new power plant, and developers are unlikely to devote the years of necessary effort to planning and permitting, for the payoff of a one-year contract at an uncertain price three years in the future.

It was the capital-intensive nature of generation development, and the long time frames associated with planning, permitting, development and capital recovery for generating plants that led the FERC to observe, early in its supervision of the PJM centralized capacity auction, that long-term financial arrangements (which are not available in the shorter term commitment construct of the PJM auction) were paramount:

> . . . [W]e are mindful of the comments made to us by representatives of the financial community, that dependence on price volatility for investment is an inadequate foundation for cost-effective financing of new infrastructure. A clear preference for long-term contracts and/or reliable revenue streams was stated. Ideally, the market should encourage [load-serving entities] to engage in long-term bilateral contracting to support needed investment. . . .[12]

In its initial order accepting elements of the RPM proposal, the FERC "conclude[d] that, after [load-serving entities] have had an opportunity to procure capacity on their own, it is reasonable for PJM to procure capacity in an open auction …," but "[t]his, however, should be a last resort." *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, P 71 (2006). As the FERC described it, PJM's centralized capacity auction provides that load-serving entities "may either (a) build their own needed capacity or create an incentive for the construction of new capacity by entering into long-term bilateral

[12] *PJM Interconnection, L.L.C*, 107 FERC ¶ 61,112 at P 20 (2004).

agreements, (b) refrain from entering into bilaterals and pay the (presumably higher) prices set by the [proposed RPM auction] demand curve, or (c) develop transmission or demand response solutions to capacity problems." *Id*, P 172. Soon thereafter, the FERC approved a settlement that "preserve[d] provisions of [PJM's proposal] that support self-supply and bilateral contracts …." *PJM Interconnection*, 117 FERC ¶ 61,331, P 29. In 2011, the FERC approved amendments to the PJM capacity auction rules, but those rules continued to provide for participation in the auction by capacity resources that load-serving entities own or acquire by bilateral contract. *PJM Interconnection, L.L.C.*, 135 FERC ¶ 61,022, PP 191–197, *order on reh'g*, 137 FERC ¶ 61,145 (2011), *rev. denied sub nom. N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d 74 (3rd Cir.). The currently effective centralized capacity auction structure contains provisions to accommodate self-supplied capacity that load-serving entities own or acquire in the bilateral market. *N.J. Bd. of Pub. Utils, supra*, 744 F.3d at 83 n. 4. *See PJM Interconnection, L.L.C.*, 143 FERC ¶ 61,090, PP 107–115 (2013), *order on reh'g*, 153 FERC ¶ 61,066 (2015).

I. The Federal Power Act does not preempt the field in which the Maryland Commission's order operates.

The Fourth Circuit found the Maryland Public Service Commission's directive to Maryland utilities engaged in providing Standard Offer Service to enter into a CfD with Petitioner CPV Maryland to be "field preempted because it functionally sets the rate that CPV receives for its sales in the PJM auction" (14-614 Pet. App. at 19a). This characterization is literally incorrect, as shown by the court of appeals' own description of the CfD (14-614 Pet. App. 14a):

> The [Contract for Differences] required CPV to build a plant and sell its energy and capacity on the federal interstate wholesale markets. If CPV successfully cleared the market, it would be eligible for payments from the [Maryland Electric Distribution Companies] amounting to the difference between CPV's revenue requirements per unit of energy and capacity sold (set forth in its winning bid) and its actual sales receipts. These costs would in turn be passed on to the EDCs' retail ratepayers. If CPV's receipts exceeded its approved revenue requirements, it would be obligated to pay the difference to the EDCs. The CfDs did not require CPV to actually sell any energy or capacity to the EDCs.

What the court of appeals described is a hedge, for a twenty-year term, against price volatility in twenty annual RPM Base Residual Auctions that establish a single year's auction price, three years in advance of the effective date of the capacity option sold in the Base Residual Auction. That hedge operates bilaterally, between the Maryland EDCs and Petitioner CPV, to provide the kind of "incentive for the construction of new capacity by entering into long-term bilateral agreements" that was precisely contemplated by the FERC as operating in parallel to the PJM RPM centralized capacity auctions (115 FERC ¶ 61,079 at P 172). The CfD does not involve any review of wholesale electric power rates by the Maryland Commission, nor does it purport to empower the Maryland Commission to prescribe or to modify any rates or charges resulting from PJM's centralized capacity auction, the Base Residual Auction. Instead, the CfD is an exchange, between the Maryland EDC and Petitioner CPV, of the risk of particular outcomes of the Base Residual Auction in the FERC-regulated PJM centralized capacity market. The CfD does not determine the auction's outcomes and, for the reasons explained immediately below, financial positions exchanged under the CfD relative to the price set by the auction cannot influence the outcomes of the PJM capacity auction. The operation of the CfD is thus entirely consistent with the FERC's early recognition in its Reliability Compensation Policy Order that "dependence on price volatility for investment is an inadequate foundation for cost-effective financing of new infrastructure" and that "the market should encourage [load-serving entities] to engage in long-term bilateral contracting to support needed investment" (107 FERC ¶ 61,112 at P 20).

The Maryland Commission set no rate in this case. Nor could its directive to the EDCs operating under its supervision have displaced any action undertaken by the FERC, because utilities – not the FERC – set rates under the FPA. In its bid in response to the Maryland request for proposals, Petitioner CPV set the rate at which it was willing to enter into the twenty-year CfD with the Maryland EDCs. As the District Court recognized (14-614 Pet. App. 125a-126a), PJM (another public utility) set the price at which CPV was permitted to bid in the 2012 Base Residual Auction, which in turn determined a one-year level of payments to CPV for its assumption of capacity supply obligations under the PJM RPM. The Fourth Circuit's field and conflict preemption conclusions in this case both rest on that Court's misplacement of the locus of rate setting authority under the FPA.

Prior to the decision below, it had long been understood that:

> Sections 205 and 206(a) 'are simply parts of a single statutory scheme under which all rates are established initially by the (utilities), by contract or otherwise, and all rates are subject to being modified by the Commission upon a finding that they are unlawful. The Act merely defines the review powers of the Commission and imposes such duties on (utilities) as are necessary to effectuate those powers; it purports neither to grant nor to define the initial rate-setting powers of (electric utilities).'[13]

In the FPA, Congress "departed from the scheme of purely tariff-based regulation and acknowledged that contracts between commercial buyers and sellers could be used in ratesetting." *Verizon Communs., Inc. v. FCC*, 535 U.S. 467, 479 (2002). The result of Congress's decision to rely on contractual rate setting means that the Act "is premised on contractual agreements voluntarily devised by the regulated companies" (*Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968)). Concomitantly, the FERC has no authority to require a public utility "to cede rights expressly given to them

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[13] *Papago Tribal Utilities Authority v. FERC*, 610 F.2d 914, 924 (D.C. Cir. 1980), *quoting United Gas Pipeline Co. v. Mobile Gas Service Co., supra*, 350 U.S. at 341.

in section 205 of the Federal Power Act . . . . The very statutory rights given to them by Congress," *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 9-10 (D.C. Cir. 2002) – including, as relevant to this case, the right to establish rates subject to review of the FERC.

Here, Petitioner CPV set the "rate" in the CfD. To the extent that rate was subject to Section 205 or 206 of the FPA, it was incumbent upon Petitioner CPV to make the appropriate filing with the FERC and to demonstrate that its rate was just, reasonable and not unduly discriminatory (*Cal. Pub. Utils. Comm'n*, 132 FERC ¶ 61,047 at P 69 (2010)), or, in the alternative, to defend against a complaint by a third party that the rate was not just and reasonable. The Maryland Commission did not "set" any rate in connection with the CfD. The terms of the state's Request for Proposal (RFP) merely reflected the state's preferences as a customer in the market. They did not set prices in either the bilateral or centralized capacity markets.

Even had Maryland's RFP required a specific contract price (or a gradually escalating price over the contract's term), and CPV simply assented to Maryland's price, the FPA and field preemption analysis would be unchanged. CPV did not have to agree to Maryland's requested price; it could simply have declined to respond to the RFP. By agreeing to a contract price requested or even specified by Maryland, however, CPV legally sets the contract price for purposes of the FPA, and Maryland's prior action in issuing the RFP is not field preempted. The price requested or specified by Maryland and agreed to by CPV would be subject to FERC review; but Maryland's action would not be preempted, because for purposes of the FPA, it is CPV's contractual assent to the price that sets the price to be reviewed.

In addition, the CfD neither had nor could have had any effect on the price that Petitioner CPV received in the Base Residual Auction. As the District Court found (Pet. App. at 125a-126a), Petitioner CPV's bid was established by PJM itself under its Minimum Offer Price Rule (MOPR), a bid price that was based on PJM's determination of the costs of its proposed generating facility, calculated by PJM, not Maryland, *without* the benefit of the CfD.[14] The PJM-established bid for CPV's capacity was below the clearing price set by the Base Residual Auction. CPV's bid, as allowed by PJM under its FERC-approved tariff, therefore "cleared" the 2012 Base Residual Auction for 2015 supply obligations (*id.*), at a price level that both PJM and the FERC concluded satisfied the statutory "just and reasonable" standard of FPA Sections 205 and 206. *PJM Interconnection, L.L.C.*, 143 FERC ¶ 61,090 at P 143 (2013).

The Maryland Public Service Commission's directive, to utilities subject to its authority, to promote the construction of new generation within Maryland by entering into a hedging arrangement with the developer of that new generation does not

[14] PJM's Minimum Offer Price Rule requires individualized scrutiny of proposed bids in the Base Residual Auction that fall below specified thresholds, in order to prevent non-PJM revenues that may not be available to other bidders from influencing the clearing price in the Auction. The history, evolution and purpose of the PJM MOPR is explained at length in *N.J. Bd. of Pub. Utils. v. FERC*, *supra*, 744 F.3d at 84-92.

trespass on any authority conferred upon the FERC by the FPA. Far from showing any "clear and manifest purpose of Congress" to supersede historic police powers of the States (*Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996)), and recognizing instead that "the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the states," *Ark. Elec. Coop. Corp. v. Ark. Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983), the FPA does not attempt to regulate the choices of retail electric utilities among various resource options, or supply cost containment strategies, that may be available to them. Like its sister statute, the Natural Gas Act, the FPA "was drawn with meticulous regard for the continued exercise of state power."[15] Indeed, the stated purpose of the FPA was to "impose Federal jurisdiction only over those matters which cannot be effectively controlled by the States."[16]

It is by now axiomatic that "[m]arkets are not perfect, and one of the reasons that parties enter into

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[15] *Oneok, Inc. v. Learjet, Inc.*, __ U.S. __, 135 S. Ct. 1591, 1599, 191 L.Ed.2d 511, 522 (2015), *quoting Panhandle Eastern Pipe Line Co.* v. *Public Serv. Comm'n of Ind.*, 332 U. S. 507, 517-518 (1947). Because the relevant provisions of the Federal Power Act and the Natural Gas Act "are in all material respects substantially identical" *FPC v. Sierra Pacific Power Co.*, *supra*, 350 U.S. at 353), this Court has an "established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981).

[16] S. Rep. No. 621 (74th Cong., 1st Sess.) at 18 (1935).

wholesale-power contracts is precisely to hedge against the volatility that market imperfections produce." *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527, 547 (2008). The Maryland Commission's directive to Maryland's EDCs to enter into the hedging arrangement in this case that the Fourth Circuit concluded was preempted by the FPA is an exercise of authority properly reserved to the states[17] by Section 201(b)(1) of the FPA.[18] *See New York v. FERC*, 535 U.S. 1, 24 (2002) (explaining concurrent spheres of FERC and state regulation under FPA Section 201(b)(1)). As the FERC itself has explained, "wholesale ratemaking does not, as a general matter, determine whether a purchaser has chosen prudently among available supply options," and "[i]n most circumstances 'a state commission may legitimately inquire whether the retailer prudently chose to pay the FERC-approved wholesale rate of one source, as opposed to the lower rate of another

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[17] Reviewing the Maryland Commission's Order, the Maryland appellate court ruled that "the Commission's orders directing the EDCs to negotiate and enter into a CfD with CPV and to recover their costs, or return their credits, through the SOS were within its statutory authority." *In re Petition of Calpine Corp.* 2013 Md. Cir. Ct. LEXIS 14, *32 (Cir. Ct. Balt. 2013), appeal pending but stayed *sub nom. Md. Office of People's Counsel v. Md. Pub. Serv. Comm'n*, No. 1738, Sept. Term 2013 (Md. Ct. Spec. App. docketed Nov. 6, 2013).

[18] 16 U.S.C. § 824(b)(1), which provides in relevant part that "[t]he Commission . . . shall not have jurisdiction, except as specifically provided … over facilities used for the generation of electric energy… "

source.'"[19] The Maryland Commission's directive to the EDCs operating under its regulatory authority directs those retail electric utilities to enter into contracts in order to protect their retail customers from high costs by reducing price volatility and encouraging the development of new energy infrastructure.

Indeed, the FERC had long encouraged this kind of state-driven response to price signals in connection with its oversight of centralized capacity auctions, including specifically PJM's RPM,[20] at least

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[19] *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, *order on reh'g*, Order No. 697-A, *supra*, FERC Stats. & Regs. ¶ 31,268 at PP 415-416 & n. 567, *quoting Pike County Lt. & Pwr. Co. v. Pa. Pub. Util. Comm'n*, 465 A.2d 735, 738 (1983).

[20] *N.Y. Pub. Serv. Comm'n v. NYISO*, 153 FERC ¶ 61,022 at P 61 (2015) ("We recognize the need for certain load serving entities to plan on a long-term basis. A well-formulated self-supply exemption will allow a load serving entity to procure a portfolio that best allows it to manage its assessment of the risks it faces and. . . eliminates the risk of effectively requiring load serving entities to pay twice for capacity in the event that a self-supplied resource does not clear the capacity market"); *ISO New England, Inc.*, 138 FERC ¶ 61,027 at P 74 (2012) ("The establishment of such an offer floor does not prohibit parties from self-supplying. Parties may self-supply with existing capacity, which is not subject to the economic benchmarks established by the April 13 Order. Parties may also self-supply with new capacity, provided these new resources clear the auction"); *PJM Interconnection, L.L.C.*, 137 FERC ¶ 61,145 at P 208 (2011) ("the purpose and function of the MOPR is not to unreasonably impede the efforts of resources choosing to procure or build capacity

prior to its comments in the *amicus* brief of the United States in response to the petitions for *certiorari* in this case. FERC's repeated past acknowledgement of the importance of long-term contracts in supporting capacity required in order to satisfy the PJM region's infrastructure needs strongly counsels against the Fourth Circuit's preemption conclusion here. *Hillsborough County v. Automated Medical Labs., Inc.*, 471 U.S. 707, 721 (1985) (". . . since the agency has not suggested that the county ordinances interfere with federal goals, we are reluctant in the absence of strong evidence to find a threat to the federal goal").

The misconception that underlies the Fourth Circuit's field preemption analysis is underscored by considering the case of a municipal utility or electric cooperative whose wholesale procurement practices or rates are not subject to state regulation in most states.[21] In that case, the municipality or the

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under long-standing business models"); *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331, P 29 (2006) ("The Settlement preserves provisions . . . that support self-supply and bilateral contracts through various means, including capacity pricing hubs and electronic forums for bilateral transactions"); *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112 at P 20 (2004) (". . . dependence on price volatility for investment is an inadequate foundation for cost-effective financing of new infrastructure. . . . Ideally, the market should encourage [load-serving entities] to engage in long-term bilateral contracting to support needed investment. . . .").

[21] Although Maryland is one of the few states where the state public service commission regulates the rates of its municipal utilities and electric cooperatives, the Maryland

cooperative would be able to contract directly with a generation developer without the intermediary step of a state commission directing or approving the municipality or cooperative's action. If a municipal utility or electric cooperative (or a group of them, as is often the case), published a request for a long-term contract with a generation developer identical to the one at issue here, and the parties executed such contract, would a state law authorizing this autonomous business decision by the municipality or cooperative be field preempted by the FPA? The answer assuredly is no. The Fourth Circuit's sweeping field preemption holding threatens the ability of municipal utilities and electric cooperatives to continue their long-standing practice of assembling a portfolio of power supply resources—owned or contracted for—that meets the needs of their customers for safe, reliable, affordable, and environmentally responsible power. A municipality or cooperative, like any load-serving entity, will seek to build or purchase capacity to meet a host of objectives—energy, local grid support, fuel diversity, environmental compliance, and a wide range of risk-management objectives (temporal, regulatory, fuel price, market price). These objectives cannot be met by sole use of the PJM centralized capacity market. The bilateral markets are where load-serving entities make sure they not only have enough capacity resources, but the right resources. The Fourth Circuit's decision ignores all of this and threatens not only the basic operation of the wholesale power markets, but the core business operations of load-

Commission's challenged order did not apply to any municipal utility or cooperative.

serving entities like municipality utilities and electric cooperatives.

The need for stable, long-term, contractual arrangements that provide a secure revenue stream for financing generation is well understood in the electric power industry. That need has been acknowledged repeatedly by the federal agency whose jurisdiction the court of appeals sought to protect with its preemption ruling. There is no plausible suggestion that the State regulatory initiative here poses any genuine prospect of interference with the operation of federal regulation.

II. There is no conflict between the Maryland Commission's order and FERC regulation of centralized capacity auctions, and therefore there is no conflict preemption.

The court of appeals further concluded (Pet. App. 24a–29a) that the Maryland Public Service Commission's directive that Maryland's EDCs enter into a CfD with Petitioner CPV was "conflict preempted" because it "interferes with the method by which the federal statute was designed to reach its goals."[22] The court of appeals noted two specific grounds for this conclusion. First, the Fourth Circuit stated (Pet. App. 26a) that the payments established by the Contract for Differences "directly conflict with the auction rates approved by FERC." Second, the Fourth Circuit observed (*id.*) that the term of the CfD was twenty years, in contrast to a three-year price guarantee (the "new entry price adjustment," or

[22] 14-614 Pet. App. 25a (internal quotation omitted).

"NEPA") available under PJM's centralized capacity auction rules.

The central problem with the court of appeals' identification of these "conflicts" is that the characterization fails to recognize that contractual markets operate in tandem with the RPM centralized capacity auction. The PJM centralized capacity auction is not designed to, and does not in fact, establish a uniform price for all trading related to capacity in the PJM RTO. Rather, the PJM centralized capacity auction assumes that entities responsible for serving retail electric demand have numerous options for fulfilling their capacity obligations, and that the centralized capacity auction probably represents the most expensive of those options. *PJM Interconnection, L.L.C.*, *supra*, 115 FERC ¶ 61,079 at P 172. Thus, the fact that the PJM centralized capacity auction leads to the establishment of a rate (a rate that is actually "set" by the highest bid that clears the auction) does not mean that the rate resulting from the auction is the *sole* permissible rate for capacity or capacity-related contracts. Contrary to the holding below, the PJM centralized capacity auction design expressly contemplates the contrary – multiple potential means of meeting a capacity obligation are a key feature of the PJM capacity supply regime of which the auction is a part (*id*). For this reason, "the 'complex and extensive' regulatory history and background relevant to this case . . . reveal the longstanding coexistence of state and federal law" (*Wyeth v. Levine*, 555 U.S. 555, 581 (2009)), which operate in distinct spheres with respect to the regulation of power supply acquisition choices by utilities providing retail electricity supply. *See, e.g.*, *Rochester Gas & Electric*

Co. v. Pub. Serv. Comm'n of N.Y., 754 F.2d 99, 104 (2nd Cir. 1985) (". . . the Court has . . . also acknowledged that in regulating jurisdictional activity, non-jurisdictional activity may have to be accounted for and that this recognition of non-jurisdictional activity does not necessarily constitute regulation").

The FERC long ago explained that "dependence on price volatility for investment is an inadequate foundation for cost-effective financing of new infrastructure" and that "the market should encourage [load-serving entities] to engage in long-term bilateral contracting to support needed investment." *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112 at P 20 (2004). Far from interference or obstruction of the FPA's purposes in regulating PJM's centralized capacity auction, the long-term contracting directed by the Maryland Commission in this case was, as shown by the FERC's Reliability Compensation Policy order quoted above, an intended and indispensable counterpart to the attainment of those purposes.

The court of appeals' view that the Maryland Commission's directive to the retail electric utilities at issue in this case represented "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" under the FPA (14-614 Pet. App. at 24a) turns first on the mistaken notion that there is only a single, permissible price for capacity within the RTO. This is not in fact the case because the FERC itself regulates more than one price for capacity within the PJM RTO – (1) the PJM centralized capacity price, which is set by an annual auction for a period three years in the future, and (2) the price established by any number of bilateral or non-auction capacity transactions that are intended to coexist with the price set by the centralized capacity auction. *PJM Interconnection, L.L.C.*, *supra*, 115 FERC ¶ 61,079 at P 172. The Maryland Commission's directive to its regulated retail utilities in this case affected their purchasing behavior in the second of these two settings, not the first. This was clearly within the purview reserved to the Maryland Commission under the FPA, where "wholesale ratemaking does not, as a general matter, determine whether a purchaser has prudently chosen among available supply options."[23] The fact that the Maryland Commission exercised its authority prospectively by directing its retail utilities to enter into a specific transaction, rather than retrospectively in litigation over retail rates, is of no significance to the preemption issues before this Court.

The court of appeals also opined that the Maryland Commission's directive had "the potential to seriously distort the PJM auction's price signals" either by "direct conflict with the auction rules approved by FERC" or by providing a guarantee of a fixed price for 20 years when the PJM capacity auction rules had a provision that could afford a bidder a fixed price for three years.[24] Neither of these claimed "distortions" actually affects, or is capable of affecting, the outcome of the PJM capacity auction. There is no "direct conflict" between either the price or the commitment term resulting from PJM's centralized capacity auction and the hedging arrangement

[23] Order No. 697-A, FERC Stats. & Regs. ¶ 31,268 at P 415.

[24] 14-614 Pet. App. at 25a-26a.

directed by the Maryland Commission because, as explained above, the auction regime expressly contemplates procurement (and hedging) outside of the auction itself. *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 at P 172. In this regard, "[t]he existence of a hypothetical or potential conflict is insufficient to warrant the pre-emption of the state statute," *Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982), or the state regulatory directive on contracting by retail utilities in this case.

The court of appeals' conflict preemption discussion also misunderstood the Minimum Offer Price Rule that the FERC incorporated into the PJM auction mechanics in 2011. That Rule establishes a bidding floor that is the lower of (i) a generic benchmark price calculated by PJM for the type of generator submitting a bid, or (ii) a bid price specific to the generator, again calculated by PJM, "'consistent with' the competitive, cost-based cost of new entry were the resource to rely on PJM market revenues." *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,194, P 21 (2012) (*quoting PJM*, 137 FERC ¶ 61,145, P 65), *review denied sub nom. N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d 74 (3d Cir. 2014). In this case, Petitioner CPV's bid was independently determined by PJM to meet that standard, submitted at the level approved by PJM, and cleared the PJM auction. 14-614 Pet. App. 125a-126a. The FERC expressly determined that, where bids that meet that standard and clear the PJM auction the bidding resource (here, CPV) "has demonstrated that it is needed by the market and it is therefore economic. The resource's presence in the market at this point does not artificially suppress market prices, and there is no reasonable basis for continuing to apply the MOPR to it." *PJM Interconnection, L.L.C.*, 135 FERC ¶ 61,022 at P 175 (2011). As the FERC itself acknowledged in approving PJM's MOPR, that Rule "does not interfere with states or localities that for policy reasons seek to provide assistance for new generation entry if they believe such expenditures are appropriate for their state … [but] ensures only that the wholesale capacity market prices remain at just and reasonable levels." *Id.* at P 141. The PJM Minimum Offer Price Rule allows "states to develop whatever capacity resources they wish, and to use those resources to any extent they wish, while approving rules that prevent the state's choices from adversely affecting wholesale capacity rates." *N.J. Bd. of Pub. Utils. v. FERC*, *supra*, 744 F.3d at 98. PJM's determination that CPV's bid satisfied those standards, and FERC's acceptance of that determination, demonstrate conclusively the lack of any conflict between the Maryland Petitioners' activities and the FERC-supervised functioning of PJM's capacity auction.

The United States took a contrary position in its opposition to the petitions for *certiorari*, asserting that "factual findings of the courts below . . . credited evidence that the state programs have a price-suppressive effect on the capacity markets – even after the Commission's 2011 amendment to the minimum-offer-price rule."[25] The record in this case contains no such finding. Nor have the Associations been able to reconcile the position of the United States in opposition to the petitions for *certiorari*[26] with the

[25] United States Br. Opp. Cert. at 16.

[26] *Id.* at 15-20.

FERC's consistent statements up to that point concerning the coexistence of the PJM centralized capacity auction with other, contractual capacity transactions independent of that auction.[27] In any case, the weight that this Court accords "the agency's explanation of state law's impact on the federal scheme depends on its thoroughness, consistency and persuasiveness" (*Wyeth v. Levine*, *supra*, 555 U.S. at 577). The FERC's recent change of heart on the role of procurement of capacity and related products and services independent of centralized capacity auctions, as expressed in the brief of the United States opposing *certiorari*, is entitled to little weight (if any) under the Court's criteria for evaluating agency views on preemption.[28]

The court of appeals' conflict preemption discussion, like the Government's brief in opposition to the petitions for *certiorari* in this case, overlooks the FERC's persistent efforts to ensure that the long-term bilateral contract market and PJM's centralized capacity auction operate in tandem. There is no conflict preemption involved in this case. Rather, the court of appeals indulged here in precisely the "freewheeling judicial inquiry into whether a state [action] is in tension with federal objectives" which "undercut[s] the principle that it is Congress rather

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[27] *See* cases cited in the preceding paragraph and note 20, *supra*.

[28] The United States has "not pointed to a specific FERC determination" that directives like the Maryland Commission to the retail electric utilities it regulates are preempted by the FPA. *Oneok, Inc. v. Learjet, Inc.*, *supra*, 135 S. Ct. at 1602-1603, 191 L. Ed.2d at 525.

than the courts that pre-empts state law." *Gade v. Nat'l Solid Wastes Mgmt. Assn.*, 505 U.S. 88, 111 (1992) (Kennedy, J., concurring in part and concurring in the judgment).

CONCLUSION

For the foregoing reasons, the Court should reverse the decision of the court of appeals and remand this proceeding with directions that it be remanded to the district court for dismissal.

Respectfully submitted,

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