Federal District Courts Hold State Efforts to Develop New Electric Generation Plants Needed for Reliability Are Preempted

Two recently decided cases by the US District Courts for the District of Maryland and the District of New Jersey have potentially far reaching implications for state regulatory commissions. The District Courts find that Maryland and New Jersey initiatives to develop new generation facilities to address in-state reliability needs impermissibly regulate in the area of wholesale energy rates, a domain reserved exclusively to the Federal Energy Regulatory Commission (FERC) under the Federal Power Act (FPA), and thus run afoul of the Supremacy Clause of the US Constitution.

These twin decisions represent ominous news for state regulatory commissions by broadly construing the scope of FERC's wholesale rate authority under the FPA, while narrowly interpreting the scope of state authority to regulate generation facilities. Although both determinations may be challenged on appeal, the decisions as they stand suggest that competitive electricity procurements administered by state regulatory commissions may be invalidated in their entirety to the extent those initiatives are deemed to establish rates for wholesale transactions.

Both courts provide a quantum of solace to state regulatory commissions in rejecting plaintiffs' dormant Commerce Clause challenges to the state procurements. In so holding, the courts appear to recognize that states may reasonably seek to develop new generation in transmission-constrained areas that have seen high capacity prices and no new generation development, and that such new development does not necessarily impair the ability of incumbent generators to sell energy and capacity in regional markets.

Maryland: The State Commission's Generation Order Is Field Preempted

In *PPL Energyplus, LLC v. Nazarian*, the District Court of Maryland invalidated a Maryland Public Service Commission order (Order No. 84815, the Generation Order) directing Maryland's utilities to enter into a "contract for differences" with a generation developer selected on the basis of an open, competitive solicitation conducted by the Maryland Commission. The contract would provide a long-term, guaranteed revenue stream to finance the construction of a new generation facility to assure the reliability of the state's electricity supply. No. 12-1286 (D. Md. Sept. 30, 2013) (Garbis, J.).

The District Court found that the Generation Order "sets or establishes the ultimate price received by CPV for . . . wholesale energy and capacity sales" into the PJM-administered market and thus encroached on the field of wholesale rate setting authority reserved exclusively to FERC. Slip Op. at 111-12. In so doing, the court rejected arguments that the contract for differences was a financing mechanism beyond FERC's authority to regulate. In the District Court's view, the agreement was not a financial contract because it placed affirmative

obligations on the developer – e.g., to construct and operate a generation facility, to sell output into PJM's competitive markets – that would not be required in a purely financial hedge.

While the District Court acknowledged that the FPA preserves state jurisdiction over certain direct regulation of physical generation facilities – e.g., siting – the court construed such authority narrowly, merely acknowledging that states may take certain limited actions relating to generation facilities. Even if the purpose of the state action was properly within the authority reserved for the states, the District Court explained that this purpose would not be determinative of the preemption analysis.

In light of its finding that the Generation Order was field preempted, the District Court did not rule on plaintiffs' argument that it was also conflict preempted, observing only that the issue was "reasonably debatable." *Id.* at 113. The District Court also rejected plaintiffs' contention that the Generation Order violated the dormant Commerce Clause, finding that it "increas[es] the available supply of electric energy and capacity in the PJM region" but "does not affect the ability of other market participants to sell energy and capacity in the PJM Markets." *Id.* at 145.

New Jersey: LCAPP Act is Field Preempted and Conflict Preempted

In *PPL Energyplus, LLC v. Hanna*, the court invalidated New Jersey's Long-Term Capacity Pilot Project Act (LCAPP Act) as preempted by the FPA and in violation of the Supremacy Clause. No. 11-745 (D.N.J. Oct. 11, 2013) (Sheridan, J.).

The LCAPP Act established a program administered by the New Jersey Board of Public Utilities that, like the Maryland procurement, required New Jersey's utilities to enter into long-term contracts for differences that provided generator counterparties with a guaranteed revenue stream to finance the construction of new gas-fired generation facilities in New Jersey. The LCAPP Act contemplated that new generation projects would be selected through an open, competitive solicitation conducted by the state regulator.

In a brief analysis, the District Court concluded that the LCAPP Act was field preempted: "the LCAPP supplants the [FPA], and intrudes upon the exclusive jurisdiction of [FERC], by establishing the price that LCAPP generators will receive for their sales of capacity . . . . Accordingly, the LCAPP Act invades the field occupied by Congress and is preempted by the [FPA]." *Id.* at 60. In so finding, the court acknowledged that New Jersey retains responsibility for the siting and construction of power plants under the FPA, but like the Maryland District Court, appeared to construe such authority narrowly. In particular, the court enumerated certain "alternative measures" that New Jersey "could have employed to incentivize the development of new generation," including the utilization of tax exempt bonds, property tax relief, favorable site lease agreements on public lands, the gifting of environmentally damaged properties for brownfield development, and relaxed or accelerated permit approvals. *Id.*

The District Court also summarily concluded that the LCAPP Act was conflict preempted. Citing testimony submitted by the plaintiffs suggesting that the Standard Offer Capacity Agreement undermined their companies' ability to rely on price signals from the PJM-administered capacity market, the District Court concluded that "it is clear that the LCAPP Act poses as an obstacle to [FERC's] implementation of the [regional capacity market]." *Id.* at 62.

Like the Maryland court, the New Jersey District Court rejected plaintiffs' arguments that the LCAPP Act violated the dormant Commerce Clause by discriminating against out-of-state generators by seeking in-state development. *Id.* at 63-65. The District Court found that it "appears reasonable that [New Jersey] would incentivize construction in areas where reliability concerns are in flux," *i.e.*, locational deliverability areas that have seen high capacity prices due to transmission constraints, and permitted consideration of "community benefits" to the state in the procurement. *Id.*

Conclusion: Implications for State Regulatory Commissions

The Maryland and New Jersey District Court decisions upend the long-established understanding of state commissions, market participants, and even FERC that state competitive procurements such as those at issue in the *PPL* cases are lawful exercises of state authority. Indeed, it bears mention that, days after the Maryland District Court opinion issued, a state court upheld the Maryland Commission order against a challenge by Maryland EDCs as "not illegal, unreasonable, arbitrary, or capricious" under state law. *In re Calpine Corp.*, No. 24-002853 (Balt. City Cir. Ct. Oct. 4, 2013).

The Maryland and New Jersey District Court decisions are subject to appeal (to the Court of Appeals for the Fourth Circuit and the Court of Appeals for the Third Circuit, respectively) and may be reversed. However, if left undisturbed – or if affirmed on appeal – state procurements including standard offer service, new generation resources, demand response, and non-PURPA renewable energy may be vulnerable to preemption challenges based on the Maryland and New Jersey District Courts' extremely broad interpretations of FERC's wholesale rate authority under the FPA.

It is unlikely that these District Court decisions will be the last word on the validity of state initiatives to develop new generation resources. Until the federal appellate courts and/or FERC address the District Court decisions and provide clearer guidance, however, it will be necessary to proceed with caution and with even greater attention to jurisdictional issues in designing state procurements that relate to electricity supplies.

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