Supreme Court Precedents Tested Again by NY Zero-Emission Regs

Anthony Michael Sabino and Michael J. Abatemarco

Recently in these pages—in fact, quite recently—we conducted an extensive review of new US Supreme Court landmarks that unequivocally established the paramountcy of federal law regulating the interstate energy markets. This noble triad is composed of *Oneok, Inc. v. Learjet, Inc.*,[1] establishing that federal law is supreme over state promulgations regulating the natural gas industry, followed by *FERC v. Electric Power Supply Association*,[2] which likewise declared that the interstate wholesale market in electricity is subject solely to national regulation, to the exclusion of state law, and, finally, *Hughes v. Talen Energy Marketing, LLC*,[3] where, consistent with its earlier precedents, a unanimous Supreme Court voided a state-aid program to certain energy producers as an unlawful intrusion into a domain constitutionally mandated as one susceptible only to federal oversight.

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With such a formidable array of Court precedent confirming the supremacy of federal authority over these interstate markets, one would think that state governments would henceforth scrupulously avoid clashing with the national regulators, principally the Federal Energy Regulatory Commission (FERC). After all, why would local authorities engage in such an obviously futile exercise as transgressing into the federal arena, given all these robust proclamations from the nation's highest Court?

STATES ARE AT IT AGAIN

Notwithstanding the obvious clarity of the aforementioned trilogy, the more adventuresome state agencies still persist in encroaching upon territory clearly demarcated as subject solely to federal jurisdiction. These provincial regulators, asserting that what they have mandated are no more than local pronouncements, having no impact beyond their jurisdiction's borders, effectively invite litigation.

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The latest example of such a controversy is New York State's new Zero-Emissions Credit (ZEC) program being contested by major industry players in a freshly filed litigation, *Coalition for Competitive Electricity v. Zibelman*.[4] The plaintiffs' key accusations are that this state-level subsidy program in-

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trudes upon Congress's power to exclusively legislate in matters of interstate commerce and that this incursion by local lawmakers does violence to the supremacy of federal law regulating the interstate wholesale electricity market.

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Given that this case is exceedingly new, and that, at the time of this writing, we are awaiting the first ruling of a federal trial court on the plaintiffs' demand for an injunction against the effectiveness of the ZECs, our objectives are to review the indisputable federal regulation of the interstate wholesale electricity market and the allegations as to how these state-mandated credits purportedly work to intrude upon that authority.

INTERSTATE WHOLESALE AUCTIONS

Interstate commerce in electricity falls strictly within the domain of federal regulation, as a matter of constitutional law. Congress has apportioned regulatory oversight of that market to FERC. The agency leaves that task to competitive auctions, of course carefully supervised by the federal watchdogs.

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The dynamic of the interstate wholesale auctions is straightforward. Producers across the nation (and Canada) generate electricity and offer it for sale. Vast regional networks, known as "Independent System Operators" (ISOs), then bid for product. The nominal rules of supply and demand take hold, with the additional gloss of FERC assuring that there is a reliable supply for times of increased need. This competitive process reasonably assures that the best price for all is attained. Moreover, the process encourages the entry of new, more-efficient generators into the mix, and the departure of those who can no longer compete.

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For all this to work, it is imperative that outside interference with the market be firmly deflected. This includes, most especially, meddling by the states, no matter how well their edicts are disguised as beneficent or "local." Now to briefly examine the New York electricity market, and what circumstances engendered the pending lawsuit.

NEW YORK ELECTRICITY MARKET

The New York grid is managed by the New York Independent System Operator (NYISO). In order to facilitate both a sufficient supply of electricity and the reliability of its own system, the NYISO conducts highly sophisticated auctions for the purchase and sale of electricity. These auctions essentially take two forms.

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First, there is the combined "day-ahead" and "real-time" auction, whereby producers present themselves to the buyer and indicate the price at which they are willing to sell. This auction is accompanied by the equally robust "capacity" auction, wherein the NYISO comes to the marketplace, declares the amount of capacity it requires to meet anticipated demand, and then offers to buy the required electricity from producers. This process presents two sides of the same coin, in a manner of speaking.

Notwithstanding these opposing vectors, both auctions ultimately arrive at the same locus. Variations in supply and demand drive competition among producers, all looking to download product at the best possible price, while the grid simultaneously wishes to procure commitments of supply as efficaciously as possible. Natural competitive forces take hold, and, finally, a last figure, commonly known as the "market clearing price," is arrived at. This amount is now set as the uniform price that all sellers shall accept, and all buyers shall pay, at the conclusion of a given auction process.

While this wholesale clearing price can boast that it is wholly derived from unfettered market competition, it does hold a certain sensitivity all its own. The least bit of intrusion from nonmarket forces can throw the entire process into disarray. Say, for example, a governmental force decides that a particular mode of electricity production needs propping up. Assistance to that lucky entity, couched in whatever form, comes at the expense of its competitors, and the market balance so vigorously arrived at is thrown askew. In this zero-sum game, only the exclusivity of federal regulation prevents meddling by parochial interests, thus preserving a robustly competitive and, thereby, evenhanded market.

Thus, there we have it. In a perfect world, the interstate wholesale electricity market conducts business in an environment driven solely by free market forces, under the auspices of a single national agency committed to prohibiting outside interference. However, as recent Supreme Court cases have taught us, attaining that ideal is no easy task. From time to time, state authorities will seek to influence outcomes, and the inevitable litigation follows.

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That said, we can now turn to the newest example of that tension. To be sure, we note that what follows is largely drawn from the complaint filed to initiate the *CFCE* case. As such, it represents allegations, not facts, that have yet to be proven—if they ever will be—in a court of law. With that caveat, we may now proceed.

NUCLEAR PLANTS THREATEN TO CLOSE

The pending controversy finds its genesis in the travails of at least three nuclear generating plants, all situated in upstate New York. Each of the three sold electricity into the regional grid, and thereby participated in the FERC-regulated wholesale auctions. But these facilities had fallen upon hard times, economically speaking.

The Ginna and Nine Mile 1 plants, both owned by Exelon, had allegedly suffered millions of dollars in operating losses over the years. Exelon threatened to shutter both facilities, unless state aid was forthcoming. The owner justified its pleas for help upon the premise that closure of these plants would mean the concomitant loss of jobs and tax revenue.

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The third facility under economic duress was the Fitzpatrick plant, owned by Entergy but apparently up for sale to Exelon, making the latter the owner of the entire distressed fleet. Fitzpatrick shared the economic woes of its peers, and its current owner joined its potential future master in seeking relief from New York State.

NEW YORK ENACTS THE ZECs

To stem the crisis, the New York State Public Service Commission (PSC) adopted the ZEC program. According to the detailed complaint, the nuclear operators would be entitled to a sizeable per-unit premium over and above the market price for each megawatt of electricity they downloaded into the regional grid.

At the risk of oversimplification, if the interstate wholesale auction price was $20 per megawatt-hour, the fission plants would be entitled to an additional payment per unit of $17, ostensibly to cover costs and keep them up and running. Significantly, if the auction clearing price decreased, thus placing these select operators in the red, the premium would be increased commensurately, in order to guarantee their financial viability.

Keen note must be taken of the following. It would be the state PSC that decides the amount of the premium. Local regulators would determine at what levels of the interstate auction price the ZECs would take effect. Finally, the

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ZEC protocols were part of a larger regulatory order, the remainder of which was devoted to Renewable Energy Credits (RECs). Yet while any generator, regardless of source, was eligible for the RECs, the ZECs were strictly delimited to the nuclear operators.

Authorities rationalized the program as one intended to avoid the loss of the carbon-free attributes of nuclear generation while the state awaited other forms of renewable energy to come on line.

In a number of studies and public pronouncements, the Empire State authorities rationalized the program as one intended to avoid the loss of the carbon-free attributes of nuclear generation while the state awaited other forms of renewable energy to come on line in a few years. The PSC was careful to justify these steps as a matter of "public necessity." Nonetheless, the state agency did acknowledge in its background filings that current wholesale market prices were insufficient to keep the nuclear operators in business, and only relief from New York State could assure their continued operation.

COURT CHALLENGE

As one could imagine, non-nuclear generators participating in the New York regional grid were none too pleased with this dispensing of state largesse to their atomic brethren. Hence, the pending lawsuit under discussion here was filed. A brief review of the key parties is most revealing.

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The lead plaintiff, the Coalition for Competitive Electricity, is self-described as a not-for-profit trade association, representing certain electricity wholesalers whose businesses would be harmed if the ZECs take effect. The trade group is joined by several coplaintiffs, including major players Dynegy Inc. and NRG Energy Inc. NRG's participation is quite notable here, given that its diverse pool of production includes solar, wind, and nuclear, thereby placing its nuclear and other zero-carbon production assets in direct competition with the three aforementioned planned recipients of the ZECs. Finally, another complainant is the Electric Power Supply Association (EPSA), the lead plaintiff in the aforementioned *FERC v. EPSA* landmark.

The defendants are composed of Audrey Zibelman, chair of the New York State PSC, and her four fellow commissioners, all named solely in their official capacities.

As we have been fond of saying in this space, the Commerce Clause helps put the "United" in "United States."

As to the harms alleged, the plaintiffs claim several. First and foremost, they posit that the ZEC protocol is violative of both the Commerce Clause and the Supremacy Clause of the federal Constitution. As extensively discussed in our earlier writings featuring the new trilogy, only Congress can legislate in matters implicating interstate commerce. As we have been fond of saying in this space, the Commerce Clause helps put the "United" in "United States." And as the Court's triad of precedent makes beyond argument, the wholesale electricity market is an undeniable component of that commerce between the states, and one that must be vigilantly safeguarded from local interference.

Any state promulgation, not just conflicting or contradictory, but sometimes even complementary legislation, simply cannot survive in light of national enactments.

Moving on to the Supremacy Clause leg of the pending court challenge, it follows that if federal law exists on the subject matter, it must reign supreme. Any state promulgation, not just conflicting or contradictory, but sometimes even complementary legislation, simply cannot survive in light of national enactments. Otherwise, confusion would reign, followed by chaos, particularly in heavily regulated industries such as electricity and natural gas. If for no other reasons except cohesion and clarity, federal law, as made by the national legislature, must be regarded as supreme in all respects, and all local edicts nullified.

Now we will apply these dual pillars of constitutional law to the instant situation. Determining if the Supremacy Clause has been violated requires reference to the vital notion of "preemption." Readers are familiar with our past explanations of this concept, first in the form of "field preemption," and also "conflict preemption."

The former mandates that when Congress makes law in an area, its intent is to "occupy the field," and thereby push any competing state promulgations clear off the table. The latter decrees that where any local law, no matter how well-intended or benign, contradicts national imperatives, it must be irretrievably voided.

Matching the foregoing precepts to the case at bar, the plaintiffs' foremost allegation is that the ZEC protocol unlawfully interjects state authority into a regulatory space constitutionally reserved to the federal government only. Next, New York's helping hand in the form of the ZECs is an affront to the paramountcy of federal law, thereby violating the Supremacy Clause. To be sure, the plaintiffs make a two-pronged assertion, first that Congress clearly intended to occupy the field of regulating the interstate wholesale market in electricity when it bestowed FERC with supervisory power, and, second, the ZEC program is in irredeemable conflict with federal mandates regulating the interstate wholesale electricity market, and thus cannot survive.

Moreover, each of these beneficiaries is a nuclear facility, which, per force, excludes alternatives both within and without New York State, such as wind and solar, that are just as efficacious and carbon-free.

To be sure, the plaintiffs conclude with what is essentially a civil rights claim, as an outgrowth of their Commerce Clause assertions. The complaint describes how the ZEC policy is extremely limited in scope, contrived solely to benefit less than a handful of in-state generators. Moreover, each of these beneficiaries is a nuclear facility, which, per force, excludes alternatives both within and without New York State, such as wind and solar, that are just as efficacious and carbon-free. These isolationist limitations as built into the ZECs doom the protocol as discriminatory, or so the plaintiffs say.

Notable here is the following. It is customary that the body of a complaint initiating a case does not reveal the legal precedents the plaintiff shall be relying upon to make its case. Nonetheless, the complaining parties break with tradition here, and with good reason.

New York regulators, becoming aware of the Court's unanimous declaration in mid-2016, went back and reengineered the ZEC program.

The document makes reference to the Supreme Court's decision in *Hughes*, and cites it for two overt purposes. First, as a matter of factual allegation, it purports that the New York regulators, becoming aware of the Court's unanimous declaration in mid-2016, went back and reengineered the ZEC program in order to avoid *Hughes*' strictures. Second, and here pressing the point of law, the litigants declare without hesitation that this program of state aid to these select nuclear operators simply cannot survive scrutiny under the test promulgated by the unified justices in *Hughes*.

Overt exclusions of the ZEC funding amply demonstrated that it is but a state handout that unlawfully discriminates against the many, for the benefit of a select few.

In sum, the complaint alleges three fundamental injuries inflicted by the ZEC aid program, harms that can only be remedied by a judicial declaration that the proposal is null and void. First, by intruding into the interstate wholesale electricity market, the ZEC payments violate Congress's sole authority to legislate in matters of interstate commerce. Second, this state aid package flies in the face of national leg-

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islation clearly intended to occupy and preempt all else in this domain, thereby constituting a violation of the Supremacy Clause.

Third and last among the major contentions, the overt exclusions of the ZEC funding amply demonstrated that it is but a state handout that unlawfully discriminates against the many, for the benefit of a select few.

CONCLUSIONS

We wish to close this article with what we hope are a few cogent and helpful takeaways. First, we are frankly baffled at how New York State has proceeded here. How could the PSC, in the aftermath of *Hughes*, have sensibly believed that the ZEC protocol could withstand scrutiny under the teachings so recently handed down by the Supreme Court in the relevant trilogy?

As indicated herein, and make no mistake as to our thinking, we see the barest chance of this program of state aid surviving this court test in any form whatsoever. We are highly confident that District Judge Valerie E. Caproni, the trial court jurist deciding this controversy, will bring to bear the full weight of the aforediscussed triad, most especially the pronouncements of the Supreme Court in *Hughes*. If she does so—and we are confident she will—then the inevitable result shall be the nullification of New York's ZECs.

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But will matters end there? Clearly, Maryland having gotten the worse of it in the *Hughes* case apparently did not dissuade the New York PSC from launching its own protocol of state aid to participants in the interstate wholesale market. Thus, if the Empire State is willing to take the risk of running contrary to federal supremacy in this arena, will its audacity not encourage other jurisdictions to do the same? While we respectfully contend this evinces shortsightedness on the part of state lawmakers, we regrettably foresee more such ill-advised expeditions.

Nevertheless, there are some positives here. Government officials, elected or appointed, local, state, or federal, are not above the law. They must be held accountable under our system of ordered liberty. Equally so, citizens, be they individuals or businesses, have the right to oppose governmental action that violates constitutional prerogatives or otherwise deprives citizens of their rights under the law. This litigation, whatever the end result, does reaffirm those vital principles.

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Finally, we are of the belief that this iteration of *CFCE* is merely the first of three acts. Given that state authorities rarely yield to private litigants, and the plaintiffs here are well-heeled and sophisticated enough to fight back, we expect a trip to the appellate tribunal, and, ultimately, the US Supreme Court. Needless to say, predicting the result of a pending court case is about as easy as forecasting the winner of the Super Bowl, but we will say this—eventually, the Supreme Court will see this case, and we firmly believe the instant controversy shall convert the aforementioned controlling trilogy into a quartet.

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In closing, we look forward to reporting the outcome of that Court litigation when it eventually arrives.

NOTES

1. 575 US ___, 135 S. Ct. 1591 (2015), analyzed at Sabino, M. A. (2016. January). Supreme Court clarifies federal versus state authority over natural gas. *Natural Gas & Electricity, 32*(6), 1–7.
2. 577 US ____, 136 S. Ct. 760 (2016), analyzed at Sabino, A. M. (2016, May). As *Oneok* drew regulatory line for gas, so does *EPSA* for electricity. *Natural Gas & Electricity, 32*(10), 10–14.
3. 578 US ____, 136 S. Ct. 1288 (2016), analyzed at Sabino, A. M. (2016, July). Supremes affirm Supremacy Clause but point out alternatives for states. *Natural Gas & Electricity, 32*(12), 1–6.
4. ___ Fed.Supp.3d _____ (No. 16-cv-08164) (S.D.N.Y.) (VEC) (KNF) (filed October 19, 2016) (*CFCE*).