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Supremes Affirm Supremacy Clause but Point Out Alternatives for States

Anthony Michael Sabino

Participants in the energy sector know full well that they have been very much in the public spotlight these days, what with the price of oil, calls for renewable energy, and so forth. But the energy sector should also know that no less an authority than the US Supreme Court has recently been paying a great deal of attention to the business of energy, particularly as to who may regulate it.

Readers shall recall that not long ago in these pages we reviewed recent Court decisions sharply drawing the line between federal and state oversight of the natural gas and electricity industries, respectively. First, the *Oneok* decision exemplified the principle of federal supremacy over the interstate component of the natural gas industry, as first brought about by Congress with the promulgation of the Natural Gas Act (NGA), while simultaneously leaving intact state authority over predominantly local matters. *Oneok* was soon followed by *EPSA*, which reached the parallel conclusion that the interstate electricity market was likewise subject to the supremacy of federal law, as embodied in the Federal Power Act (FPA).[1]

Now the Court has stepped in to resolve yet another conflict between state and federal authorities seeking to regulate the

Prof. **Anthony Michael Sabino** (anthony.sabino@sabinolaw.com), partner, Sabino & Sabino, P.C., in New York, specializes in complex business litigation in the federal courts, including oil and gas law and government regulation. He is also a professor of law in the Tobin College of Business at St. John's University and a special adjunct professor of law at the St. John's School of Law, both in New York. He also serves on the board of the Nassau County (New York) Public Utility Agency.

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energy sector, this time in an intriguing case entitled *Hughes v. Talen Energy Marketing, LLC*.[2] Gladly embracing the Court's newfound interest in sorting out matters of such great importance to the energy industry, we now add this latest entrant to what has become a burgeoning trilogy of Court precedent.

REALITY OF THE CONTEMPORARY ELECTRICITY INDUSTRY

The modern electricity industry is far different from what it was even a few decades ago. We are pleased to report that the Court has taken notice of that, and made its adjudications accordingly. In *Hughes* and elsewhere, the justices have acknowledged the current business model, as follows.

Hughes commences with an appreciation that, first and foremost, the electricity sector today encompasses a highly competitive interstate market, a direct result of market deregulation. Today, generation specialists only produce electricity, and then sell it wholesale at competitive "capacity auctions" to load-serving entities (LSEs; for all intents and purposes, local utilities), who, in turn, resell their purchased electricity to end-users.

The efficacy of this current industry segmentation is that it snugly fits into the prevailing norms of interdependent federal and state regulation. While the Federal Energy Regulatory Commission (FERC) enjoys authority over those that generate and sell into the interstate auctions, state regulators continue to set the rules for the more-localized LSEs and similar in-state operators. Notable for our purposes here, the latter would include in-state power generators that confine themselves to local markets.[3]

SUPREMACY CLAUSE DRAWS THE LINE

That is how the industry crafts its natural borders. But how does the legal system draw the line of demarcation between federal authority and the ambit of state regulation pertaining to the energy industry? Above all else, the constitutional imperative to be enforced by the Court in these matters is the Supremacy Clause.[4] As its very title declares, acts of Congress are the supreme law of the land, and any contradictory law promulgated by the states must yield to that federal supremacy.

In turn, Supremacy Clause jurisprudence gave rise to the doctrine of "preemption," a maxim possessed of its own subtleties. One of these nuances is the canon of *field preemption*.

Field preemption means that when Congress makes clear its intention for federal law to dominate a field of endeavor, then the relevant congressional enactments shall reign supreme. Any state law that countermands, confuses, or imposes any sort of obstacle to that federal hegemony is ousted. This notion of "occupying the field" is often portrayed via the pragmatic metaphor of Congress "knocking off the table" any state enactment that works to countermand national legislation.

Combining the above legal precepts with the present realities of the energy business engenders a collaborative scheme for industry regulation. One part of the arena is occupied by FERC, acting pursuant to the NGA and the FPA in superintending such components of the natural gas and electricity industries that conduct business across state lines. Interstate rate setting is a most pungent example of what falls within the federal purview. In contradistinction, purely local matters, such as promoting the construction of new generation facilities, readily fall within the scope of complementary state lawmaking.

But the Supremacy Clause forbids any overlap between these respective federal and state regulatory schemes. For as the late Justice Antonin Scalia said nearly three decades ago, in yet another energy-related landmark case, "[I]f FERC has jurisdiction over a subject, the States cannot have jurisdiction over the same subject."[5]

Notwithstanding the seeming clarity of these guiding principles, controversy still abounds, as *Oneok* and *EPSA* so ably demonstrated. In *Hughes*, the Court was called upon once again to apply these maxims and sort out yet another clash between federal and state regulators seeking to control the same piece of energy industry territory. All that said, we may now proceed to the case itself.

HUGHES—STATE SUBSIDIES CLASH WITH FEDERAL RATES

To begin, we must note from the outset that Hughes was not sued personally. The case bears his surname because he is chairman of the Maryland Public Service Commission (PSC), and, as such, was named in his official capacity. More to the point, it was the Maryland PSC that had initiated a program of effectively subsidizing power generation newly built in the state, and therein lies the root of the conflict.

Around 2009, Maryland authorities became concerned their jurisdiction lacked in-state

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generation facilities, and, as a direct result, was too dependent upon outside providers. The state had some very real concerns: it occupies a very congested part of a regional grid that supplies electricity to all or parts of some 13 Mid-Atlantic and Midwestern states and the District of Columbia. Given the overcrowding of the relevant grid, assuring a reliable flow of electricity into the state was problematic, to say the least, especially during times of peak demand.

The Maryland PSC hit upon the notion of subsidizing the construction of new generating facilities within its jurisdiction. While paid out by the state, these subsidies were interwoven with the rates paid at the capacity auctions, those prices already set and approved pursuant to FERC rulemaking. One can already perceive this not-so-subtle clash between FERC's authority to decide what generators could charge at auction and the undercutting of those very rates to the benefit of new entrants eligible for the Maryland subsidy.

This perceived inequality led to a court challenge by Talen Energy, an incumbent generating concern. Its paramount allegation was that Maryland's monetary support for local companies impermissibly overrode the capacity auction rates regulated by FERC. As an aside, prior to the instant litigation, FERC itself has expressed opposition to Maryland's subsidies, as well as similar programs inaugurated in other jurisdictions, on the grounds that such state action unlawfully interfered with the federal agency's statutory authority.

Against those facts, the Court made its ruling.

JUSTICE GINSBURG SPEAKS FOR A UNITED COURT

Writing for a unanimous bench, Justice Ruth Bader Ginsburg readily identified the paramount issue in *Hughes*: did the Maryland subsidy program violate the Supremacy Clause? Related thereto, was this state proviso preempted by existing federal statutes? If the Court were to find that Congress did indeed intend to occupy the field, then local law would have to succumb to federal supremacy.

The Court straightaway declared that the Maryland law did indeed violate the Supremacy Clause.

Without mincing words, the Court straightaway declared that the Maryland law did indeed violate the Supremacy Clause. By unquestionably impacting a rate for the interstate sale of electricity, a rate already approved by FERC, the local law usurped the agency's exclusive authority upon that subject.

The Court declared that Congress had bestowed upon FERC the singular power to set interstate rates. Yet the Maryland subsidy program violated that exclusivity, by virtue of providing financial benefit to new in-state generators. The state's beneficence to its local energy businesses amounted to an illegitimate influence upon the interstate capacity auction. Given the clear congressional intent to occupy the field, the contrary state law could not stand.

In reaching this result, the Court made reference to its recent landmarks, and reminded all that any Supremacy Clause analysis must be firmly grounded upon first ascertaining the target at which a particular state proviso is aimed. If it is determined that the target lies on the federal side of the line, then the state law is preempted. The *Hughes* Court had no difficulty in making such a finding here, declaring that the subsidy law promulgated by Maryland "invade[d] FERC's regulatory turf."

Moving to regularize its many precedents upon this subject, most especially the recent duality of *Oneok* and *EPSA*, the justices acknowledged the symmetry of the NGA and the FPA, the former fully occupying the field of interstate commerce in natural gas, while the latter guaranteed companion federal supremacy over the interstate market for electricity. While this part of the ruling was surprisingly relegated to a mild footnote, the Court was still explicit in acknowledging that these two bodies of federal law are unmistakably analogous (an important touchstone for future controversies in this realm).

Given these strong parallels, the justices were wholly justified in "routinely rel[ying] on NGA cases in determining the scope of the FPA." Put another way, *Hughes* stated that, given the regulatory schemes that Congress had wrought over the decades, it was not only inevitable but correct for the federal courts to both recognize and perpetuate the symmetry between these adjacent bodies of federal regulation.

Moving on to the next point, the Court asked if its consideration of this dispute should in any way take cognizance of the subjective intentions of Maryland's lawmakers to do only good for their constituents by means of this subsidy program. The justices answered that question in the negative, declaring that the internalized musings of local authorities were irrelevant to a Supremacy Clause analysis.

Internalized musings of local authorities were irrelevant to a Supremacy Clause analysis.

To be sure, noted Ginsburg, the several states remain at liberty to regulate local energy matters, including fostering the building of new generation facilities within their borders. The justices candidly allowed that Maryland could have promoted additional homegrown generation by permitting local operators to recover FERC-mandated charges in some different manner. But that misses the point at work here, declared the Court.

The fact remained that the Maryland subsidies went far beyond mere local regulation. The justices characterized the state's assistance to new in-state generators as equivalent to second-guessing the rationality of the interstate rates approved by FERC. Granting subsidies to favored entities, no matter the motivation, is an intrusion into the federal realm. Such adventurism by the states is forbidden by the Supremacy Clause, and is nullified by the preemption doctrine.

Significantly, the justices also wholeheartedly rejected Maryland's contention that its local laws merely affected the buying and selling of capacity outside the interstate auction regulated by FERC. To the contrary, these state-sanctioned subsidies undeniably impacted the wholesale rates that the capacity auctions rationalized, and thereby violated federal supremacy over the interstate market. Once again, principles of preemption demanded this affront to FERC's congressionally mandated authority be remedied by ousting the state law from the playing field.

Yet the unanimous Court was nothing if not circumspect in its judgment. Writing for her brethren, Ginsburg was most explicit in noting that today's holding was quite limited in scope. The Court was most explicit that the Maryland law was voided solely because it undermined an interstate wholesale rate, a rate that only federal regulators are empowered to set.

In contradistinction, the Court would not and did not "address the permissibility of various other measures States might employ to encourage development of new or clean generation" of energy. Indeed, *Hughes* went so far as to gently outline what steps might in fact remain to the discretion of the states when regulating energy businesses found within their borders. Ginsburg listed, among other things, tax incentives, land grants, direct subsidies, and the construction of state-owned generation facilities as a few examples of how states could remain on their side of the federal/state divide, and yet still encourage new energy generation and similar local objectives.

In closing, the Court in fact adopted a conciliatory tone. "Nothing in this opinion should be read to foreclose Maryland and the other States from encouraging production of new or clean generation," so long as such programs do not intrude upon the wholesale markets specifically reserved for solely federal regulation. Thus, while pointing out the fatal flaw in Maryland's misdirected program, the Court was just as quick to recognize other avenues by which state lawmakers could legislate appropriately.

Ginsburg expressed *Hughes*' outcome in but a few words, "States may not seek to achieve ends, however legitimate, through regulatory means that intrude on FERC's authority over interstate wholesale rates, as Maryland has done here."

And so *Hughes* concluded, with the Court employing the doctrine of preemption to assure the supremacy of federal over state law—in this particular instance, the power of FERC to regulate the interstate electricity market. Yet before departing the matter entirely, the high Court was kind enough to provide both lawmakers and the lower courts with some insight as to what measures undertaken by local lawmakers would, in all likelihood, pass judicial muster under those same axioms of constitutional law.

What is the energy industry to make of both the explicit prohibitions and the implicit permissions found in the *Hughes* decision? We propose the following.

WHAT'S NEXT FOR THE INDUSTRY?

Let us first address the matters of the Supremacy Clause and the preemption doctrine. When all is said and done, the ultimate holding of *Hughes* should come as no surprise.

After all, we just witnessed in *Oneok* the Court affirming federal supremacy over the

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interstate portion of the natural gas industry. This was quickly followed by *EPSA*, wherein the Court acted in identical fashion to verify federal domination of the interstate component of the electricity sector. In each instance, the justices made explicit not only the supremacy of federal law in these matters, but also the concomitant fact that any countervailing state regulation was preempted.

The *Oneok* and *EPSA* duo is now converted to a trilogy, thanks to *Hughes*. This latest proclamation by the Court inevitably reached the same result as its peers, based upon a consistent application of the maxims of the Supremacy Clause and the preemption doctrine. Thus, our first "takeaway" is that federal law continues to reign supreme over the energy sector, and rightly so under our federal Constitution. Second, the ancillary doctrine of preemption shall continue to push off the playing field any attempt at state regulation that is found to usurp federal hegemony over the interstate energy markets.

None of this should come as a surprise to the industry. However, it is reassuring to know that the *status quo* is being maintained by the Court. Yet the story does not quite end there.

While the trilogy speaks strongly to federal supremacy, *Hughes* remains notable for its explicit preservation of state authority, where appropriate. The newest member of the trio assures that the states remain at liberty to regulate matters that transpire purely within their own borders. Moreover, the justices were even thoughtful enough to elaborate upon specific mechanisms still available to local authorities to promote the energy industry within their own jurisdictions. *Hughes* remains notable for its explicit preservation of state authority where appropriate.

Consider how carefully the *Hughes* Court sketched out the permissible means whereby the states may continue to play a role in regulating in-state energy affairs, including, but not limited to, legislating tax breaks, land grants, and similar benefits aimed at encouraging local players. Ginsburg makes clear that, so long as such efforts do not intrude into the federal domain, the states remain free to make law.

But make no mistake: *Hughes* makes it clear that the Supremacy Clause and the preemption doctrine are not mere academic abstractions. Rather, they persist as guiding principles for apportioning the oversight of the energy industry between respective federal and state regulators.

As such, the industry may continue to confidently rely upon the supremacy of federal law and the authority of FERC for those parts of its operations that transcend state lines. Equally so, state regulators retain their own authority to regulate matters strictly limited to their own backyards, presuming their local regulations do not transgress upon federal authority.

CONCLUSION

For our summary, we assert that, insofar as the energy industry is concerned, the trilogy of *Oneok*, *EPSA*, and *Hughes* now forms the cornerstone of Supremacy Clause jurisprudence, as well as the concomitant preemption doctrine, as they shall be applied to the sector's businesses. Yet notwithstanding the pervasive scope of that awesome national power, one need only read *Hughes* to see the number of intriguing possibilities mapped out by the Court for the continued role of the states in energy regulation.

We have no doubt whatsoever that state legislatures shall now explore those boundaries, as set out by the justices in this new triad of rulings. We are equally confident that, from time to time, FERC, the industry, or both shall resist any perceived encroachment upon territory they contend is the exclusive province of federal authority.

When these controversies arise, the Court shall be called upon to make further rulings, and thereby refine its precedents. That means future articles on this vital subject, and that is something we look forward to writing for this readership.

NOTES

1. See Sabino, M. A. (2016, January). Supreme Court clarifies federal versus state authority over natural gas. *Natural Gas & Electricity, 32*(6), 1–7 (discussing *Oneok, Inc. v. Learjet, Inc.*, 575 U.S. ____, 135 S. Ct. 1591 (2015)); Sabino, A.M. (2016, May). As *Oneok* drew regulatory line for gas, so does *EPSA* for electricity. *Natural Gas & Electricity*, *32*(10), 10–14 (discussing *Federal Energy Regulatory Commission v. Electric Power Supply Association*, 577 U.S. ___, 136 S. Ct. 760 (2016) ("*EPSA*")).
2. ___ U.S. ___ (No. 14-614) (April 19, 2016).
3. *See also Pacific Gas & Electric Co. v. State Energy Resources Conservation and Development Commission*, 461 U.S. 190, 205 (1983) (the construction of new power facilities, their rates and services, "have been characteristically governed by the States").
4. U.S. Const., Art. VI, cl. 2.
5. *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 377 (1988) (Scalia, J., concurring in the judgment).