**UNITED STATES COURT OF APPEALS**
**FOR THE SEVENTH CIRCUIT**

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| ELECTRIC POWER SUPPLY ASSOCIATION, *et al.*,<br><br>Plaintiffs-Appellants,<br><br>v.<br><br>ANTHONY M. STAR, *et al.*,<br><br>Defendants-Appellees | ) | Case No. 17-2445 |

**MOTION OF THE INDEPENDENT MARKET MONITOR FOR PJM FOR LEAVE TO FILE AMICUS BRIEF**

Monitoring Analytics, LLC, acting in its role as the Independent Market Monitor for PJM ("Market Monitor"), moves for leave to file the attached brief (Exhibit A) as amicus curiae supporting the appeal of Electric Power Supply Association et al. ("EPSA") of the Memorandum Opinion and Order of the United States District Court for the Northern District of Illinois Eastern Division, Case No. 17-cv-1163 & -1164, issued July 14, 2017 ("Order").

Counsel Richard Huszagh for Anthony M. Star et al. ("Illinois") does not object. Counsel Matthew Price for Exelon Corporation ("Exelon") takes no position. Counsel Stuart Singer for EPSA consents to this motion.

In support of this motion, the Market Monitor states:

1. The Market Monitor has no financial interest in the outcome of this proceeding (other than as a retail consumer). The Market Monitor represents the public

interest objectively and independently of the Federal Energy Regulatory Commission ("FERC" or "Commission"), the market operator and market participants, including Plaintiffs. The Market Monitor's interest is to promote and protect the PJM competitive wholesale electric power markets.

2. This case concerns a complaint filed by EPSA explaining that Illinois has unlawfully intruded on the exclusive authority of the FERC over the sale of electric energy at wholesale in interstate commerce under the Federal Power Act ("FPA"), 16 U.S.C. § 824(b)(1) ("Complaint"). EPSA explains that certain amendments to the Illinois Power Agency Act ("Zero Emissions Credit Subsidies Program" or "ZEC Subsidies Program") are preempted because they intrude into FERC's exclusive jurisdiction over wholesale power transactions.

3. PJM Interconnection, L.L.C. ("PJM"), operates a centrally dispatched, competitive wholesale electric power market that, as of December 31, 2016, had installed generating capacity of 182,449 megawatts (MW) and 986 members including market buyers, sellers and traders of electricity in a region including more than 65 million people in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

4. PJM is regulated by the FERC under an approach that relies on regulation through competition to ensure the lowest possible electricity prices for consumers. In

PJM, competition means that decisions about whether to enter the market, to exit the market and to remain in the market are made by suppliers based on the market fundamentals. Potential and existing suppliers must believe that the market fundamentals will determine the success or failure of their investment or they will not invest, the market will not sustain adequate supply, and the federal regulatory approach will fail. The ZEC Subsidies Program is incompatible with the PJM market design, threatens the foundations of the PJM market and interferes with the federal regulatory scheme.

5. The Market Monitor for PJM and market monitoring units for other Regional Transmission Organizations ("RTOs") and Independent System Operators ("ISOs") are established by the FERC to monitor each organized electric wholesale market and to protect the public interest in regulation through competition.[1] The Market Monitor is responsible to independently and objectively monitor "[a]ctual or potential design flaws in the PJM Market Rules;""[s]tructural problems in the PJM markets that may inhibit a robust and competitive market;" and "[t]he potential for a

[1] *See* 18 CFR § 35.28.

Market Participant to exercise market power or violate any of the PJM or FERC Market Rules."[2]

6. The Market Monitor has actively participated in a number of matters involving owners of units seeking subsidies to counter market signals and forestall retirement of financially distressed units or to enable uneconomic new entry under various pretexts.[3] The Market Monitor was granted leave to participate as amicus curiae in both cases subject to appeal here and in a case in the U.S. District Court for the Southern District of New York, and now subject to an appeal in the United States Court of Appeals for the Second Circuit, concerning substantially identical issues. *See* Notification of Docket Entry, Doc. 90, EPSA v. Star, No. 1:17-cv-01164 (April 26, 2017); Order [Granting Motion to File Amicus Brief], Doc. 96, *Coalition For Competitive Energy v. Zibelman*, No. 1:16-cv-8164 (S.D.N.Y. Jan. 9, 2017).

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[2] *See* PJM Open Access Transmission Tariff ("OATT") Attachment M § IV.B.2–4.

[3] *See*, *e.g.*, Proposed Amicus Brief of the Independent Market Monitor for PJM Opposing Defendants' Motion to Dismiss and Supporting Plaintiffs' Motion for Preliminary Injunction, U.S.D.C. for the Northern Dist. of Ill. Case No. 1:17-cv-01164-VEC (April 24, 2017); Brief of Amicus Curiae Monitoring Analytics, LLC, Acting in Its Capacity as the Independent Market Monitor for PJM, in Support of Plaintiffs, U.S.D.C. for the Southern Dist. of N. Y. Case No. 1:16-cv-08164-VEC (Jan. 9, 2017) (opposing New York's ZEC subsidies for upstate nuclear facilities, which, though external to PJM, would impact PJM markets ); Brief of Amicus Curiae Monitoring Analytics, LLC, Acting in Its Capacity as the Independent Market Monitor for PJM, in Support of Respondents, *Hughes, et al. v. Talen Energy Marketing, LLC, et al.*, U.S. S. Ct. Case No. 14-614 (January 19, 2016) (arguing that Maryland program subsidizing new natural gas units interferes with federal regulatory scheme).

7. The Market Monitor respectfully submits that its proposed brief will assist the Court in understanding the issues in this case. Here, the case for granting leave to file the Market Monitor's amicus brief is particularly compelling given that all parties have consented to or not opposed the filing.

8. The Market Monitor submits that the filing of its brief at this stage in the proceedings will not affect the existing briefing schedule, prejudice the parties, or delay the Court's resolution of the pending motion to dismiss.

9. The Market Monitor states, per Rule 29 of the Federal Rules of Appellate Procedure, that no counsel for either party authored this brief in whole or in part. No person or entity made a monetary contribution to this brief's preparation and submission.

10. For the foregoing reasons, the Market Monitor respectfully requests the Court's leave to file the attached amicus brief in support of EPSA's appeal.

## CONCLUSION

The Market Monitor respectfully requests that the court grant it leave to file the attached brief of amicus curiae.

Respectfully submitted,



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# EXHIBIT A

**IN THE UNITED STATES COURT OF APPEALS**
**FOR THE SEVENTH CIRCUIT**

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**Nos. 17-2445**

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**ELECTRIC POWER SUPPLY ASSOCIATION, ET AL.,**
**PLAINTIFFS-APPELLANTS,**

v.

**ANTHONY M. STAR, ET AL.,**
**DEFENDANTS-APPELLEES**

– – – – – – – – – – –

*APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION, NO. 1:17- CV-01164, ET AL., HON. MANISH S. SHAH, PRESIDING*

– – – – – – – – – – – –

# AMICUS BRIEF OF THE INDEPENDENT MARKET MONITOR FOR PJM IN SUPPORT OF PLAINTIFFS-APPELLANTS

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# CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 17-2445

Short Caption: EPSA v. Star

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

The Court prefers that the disclosure statement be filed immediately following docketing; but, the disclosure statement must be filed within 21 days of docketing or upon the filing of a motion, response, petition, or answer in this court, whichever occurs first. Attorneys are required to file an amended statement to reflect any material changes in the required information. The text of the statement must also be included in front of the table of contents of the party's main brief. Counsel is required to complete the entire statement and to use N/A for any information that is not applicable if this form is used.

[ ] PLEASE CHECK HERE IF ANY INFORMATION ON THIS FORM IS NEW OR REVISED AND INDICATE WHICH INFORMATION IS NEW OR REVISED.

(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P 26.1 by completing item #3):

Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

N/A

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and

N/A

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

N/A

Attorney's Signature: Jeffrey Mayes Date: July 25, 2017

Attorney's Printed Name: Jeffrey Whitefield Mayes

Please indicate if you are Counsel of Record for the above listed parties pursuant to Circuit Rule 3(d). Yes x No

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## INTEREST OF AMICUS CURIAE

The Market Monitor has no financial interest in the outcome of this proceeding (other than as a retail consumer). The Market Monitor represents the public interest objectively and independently of the FERC, the market operator and market participants, including Plaintiffs.

The petition for review in this case concerns a complaint filed by EPSA explaining that Illinois has unlawfully intruded on the exclusive authority of the Federal Energy Regulatory Commission ("FERC") over the sale of electric energy at wholesale in interstate commerce under the Federal Power Act ("FPA"), 16 U.S.C. § 824(b)(1) ("Complaint").

PJM Interconnection, L.L.C. is regulated by the FERC under an approach that relies on regulation through competition to ensure the lowest possible wholesale electricity prices for consumers.[4] Competition means that decisions about whether to enter the market, to exit the market and to remain in the market are made by suppliers based on market fundamentals. Potential and existing suppliers must believe that the market

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[4] PJM operates a centrally dispatched, competitive wholesale electric power market that, as of December 31, 2016, had installed generating capacity of 182,449 megawatts (MW) and 986 members including market buyers, sellers and traders of electricity in a region including more than 65 million people in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

fundamentals will determine the success or failure of their investment or they will not invest, the market will not sustain adequate supply, and the federal regulatory approach will fail. The ZEC Subsidies Program is incompatible with the PJM market design, undercuts market fundamentals, threatens the foundations of the PJM market and interferes with the federal regulatory scheme.

The ZEC Subsidies Program originates from the fact that competitive markets result in the exit of uneconomic and uncompetitive generating units. The ZEC Subsidies Program would provide subsidies to specific, uneconomic generating units. Regardless of the specific rationales offered for the subsidies, the proposed solution for the selected generating units is to provide out of market subsidies in order to keep uneconomic units in the market.

The Market Monitor for PJM and market monitoring units for other Regional Transmission Organizations ("RTOs") and Independent System Operators ("ISOs") are established by the FERC to monitor each organized electric wholesale market and to protect the public interest in regulation through competition.[5] The Market Monitor is responsible to independently and objectively monitor "[a]ctual or potential design flaws in the PJM Market Rules,""[s]tructural problems in the PJM markets that may inhibit a

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[5] *See* 18 CFR § 35.28.

robust and competitive market," and "[t]he potential for a Market Participant to exercise market power or violate any of the PJM or FERC Market Rules." The issues raised in this case have important and direct implications for these areas of responsibility because the ZEC Subsidies Program will harm the competitive market by changing Exelon's incentives to behave competitively, deterring competitive investment and distorting market outcomes.

## SUMMARY OF ARGUMENT

The order granting the motion to dismiss the complaint in this case is based on improper findings of fact and misapplication of the law of preemption.

The core finding of fact in this case is whether or not an improper tether exists between the state program subsidizing certain nuclear units and federal regulation of the wholesale rates received by those units. The complaint provides ample support for the existence of a material tether. The existence of a tether is plain in the details of the subsidy program. The District Court should have conceded to plaintiffs the core fact that a tether exists at this stage of the proceeding. Instead, the District Court determined that there is no tether. The order also makes other improper findings of fact against plaintiffs.

The District Court fails to properly apply the most recent and the most applicable precedent, the Supreme Court's decision in *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288 (2016). *Hughes* is controlling. The facts in that case and in this case are nearly identical. Careful analysis of the subsidies program shows that it operates in the same way as the contract for differences in *Hughes*. The issues presented are the same, and the legal outcome should be consistent. The District Court interprets *Hughes* unduly narrowly and misapplies it to the facts of this case. The District Court relies excessively on prior case law that involves circumstances substantially different from the

circumstances involved in this case. To extent that *Hughes* conflicts with prior guidance from the Supreme Court, *Hughes* supersedes those cases. There is no way to distinguish *Hughes* from this case and to consistently apply the law of preemption, and yet that is precisely what the District Court attempts to do. The order should be reversed.

## ARGUMENT

### I. The District Court Improperly Relies On Findings of Fact Adverse to Plaintiffs.

The District Court properly observes that "[w]hen analyzing a motion under Rule 12(b)(6), a court must accept all factual allegations as true and draw all reasonable inferences in the plaintiff's favor," citing *Virnich v. Vorwald*, 664 F.3d 206,212 (7th Cir. 2011).[6] The Order improperly ignores this rule and dismisses the Complaint on the basis of adverse and incorrect findings of fact.

Plaintiffs allege that the ZEC Subsidies Program operates as "a mechanism to provide out-of-market funding to Clinton and Quad Cities" and "distorts wholesale market price signals and directly interferes with the way in which FERC intends wholesale markets to function." Complaint at paras. 42 & 44. EPSA alleges that the mechanics of the state statute target and replace the intended market incentives for "efficient and cost effective" behavior with different artificial incentives. Complaint at paras. 43, 45–53.[7]

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[6] *See also McCauley v. City of Chicago*, 671 F.3d 611, 616 (7th Cir. 2011) (the court must accept as true all well pleaded factual allegations).

[7] The Order ignores these key passages in the Complaint, stating, counterfactually, "the complaint does not allege that the statute's true aim or purpose was to adjust or disregard wholesale rates." Order at 26 n.27. *Cf.* Complaint at 2 ("Seeking to change the results of the FERC-approved market-based auction system, the Illinois General Assembly enacted FEJA, inter alia, to prop up these two uneconomic nuclear power plants and keep them in the market for at least ten more years, via so-called Zero Emissions Credits ("ZECs").").

These questions of fact are significant because the Supreme Court relied on such findings in *Hughes*, where it held that a state program was preempted by federal wholesale rate regulation because the program "disregards an interstate wholesale rate required by FERC" and includes a "tether" to "wholesale market participation."[8] *Hughes* is rooted in a line of Supreme Court cases that emphasize "the importance of considering the *target* at which the state law aims in determining whether that law is pre-empted" [emphasis in original]. Order at 24, citing *Oneok*, 134 S.Ct. at 1599.

The requirements to receive and the mechanics for calculating ZECs reveal that the ZEC Subsidies Program targets and is tethered to the wholesale rate. Eligibility to receive the ZEC subsidy requires "a commitment to continue operating, for the duration of the contract or contracts executed under the procurement held under this

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[8] *Hughes* at 1299. The Supremacy Clause of the U.S. Constitution (art. 6, cl. 2), provides that federal law preempts state law, rendering it inoperative, (1) when the express language of a federal statute declares that preemption; (2) when Congress intends the federal government to occupy a field exclusively, such as when the federal regulatory scheme is so pervasive that it may be assumed Congress "left no room for the States to supplement it"; or (3) when state law actually conflicts with federal law because it is impossible to comply with both, or because state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *English v. General Electric Co.*, 496 U.S. 72, 78–79 (1990) (citations and internal quotation marks omitted); *see also Planned Parenthood of Ind., Inc. v. Comm'r of Ind. State Dep't of Health*, 699 F.3d 962, 984 (7th Cir. 2012); *DeHart v. Town of Austin, Ind.*, 39 F.3d 718, 721 (7th Cir. 1994). "Pre-emption may result not only from action taken by Congress itself," but also from "a federal agency acting within the scope of its congressionally delegated authority." *Louisiana Pub. Serv. Comm'n v. F.C.C.*, 476 U.S. 355, 369 (1986); *see also Hillsborough County, Fla. v. Automated Med. Labs., Inc.*, 471 U.S. 707, 715–16 (1985).

subsection (d-5), the zero emission facility that produces the zero emission credits to be procured in the procurement." 20 ILCS 3855 § 1-5(d-5)(1)(A)(iv).

The Order determines that the ZEC Subsidies Program is about creating an "environmental attribute credit" that is not a "dependent transaction" to wholesale energy sales. Order at 32–33. In order for the ZEC Units to create a basis for receiving an environmental attribute credit, they must operate and sell their output in the market and displace the output and the emissions associated with the output of other units. No displacement can occur without the ZEC Units' participation in the market. The level of the environmental attribute credit is directly and explicitly tied to the price in the wholesale power market and reaches a level of zero when the price in the wholesale power market reaches a defined level, regardless of the asserted environmental benefits.

"Operating" a nuclear unit means selling the output into the wholesale energy market. No alternative scenario is available and no alternative scenario has been suggested. The state subsidy is explicitly tethered to participation in the wholesale energy market.

The rationale for targeting the wholesale rate is significant primarily because it shows that the rate was targeted and not just incidentally affected. The ZEC Subsidies Program should be preempted regardless of its goals. Hughes makes plain that legitimate objectives do not excuse states intruding on wholesale ratemaking. *See Hughes* at 1298 ("States may not seek to achieve ends, however legitimate, through

regulatory means that intrude on FERC's authority over interstate wholesale rates"). *Hughes* already presumes that state action has legitimate ends.

The level of the ZEC subsidy is explicitly tethered to the wholesale rate and targets the wholesale rate. *See* 20 ILCS 3855 § 1-5(d-5)(1)(b). The subsidy is a simple contract for differences against the wholesale market price of power. The subsidy targets a total amount of compensation to the nuclear power plants equal to the subsidy plus the current wholesale market price of power. As the wholesale price of power increases, the subsidy decreases so that total compensation remains constant. The gross value of the subsidy starts at $16.50 per MWh, and is adjusted upwards one dollar each year thereafter. *Id*. The amount of the subsidy is tied directly to market prices, termed the "baseline market price index" which equals $31.40 per MWh. The baseline market price index is equal to the PJM energy price in Illinois plus the average of the MISO and PJM locational capacity market prices. If the projected power market price ("market price index") exceeds the baseline market price index, the subsidy is reduced by the amount of the difference. If the market price index equals the subsidy plus the baseline market price index, the subsidy goes to zero, but never below zero. *Id*.

The level of the ZEC subsidy is tethered to and changes the federal regulated wholesale prices, raising the price that Exelon receives for the ZEC Units' output and changing Exelon's market incentives in ways that distort market outcomes. When

federally regulated wholesale prices rise to a specified level under the program, the ZEC subsidy disappears.

There is an explicit tether between the ZEC subsidy and federally regulated wholesale energy prices. The tether is the core factual issue in this case. The question of whether there is targeting of wholesale market prices and a tether to wholesale market prices is a matter of fact that must be conceded to EPSA in deciding on a motion to dismiss. EPSA is entitled to an opportunity to prove these facts, which would support its legal claim for relief under *Hughes*.

The Order should have accepted EPSA's proposed finding of fact that a tether exists in resolving the motion, but instead, it relies on findings of fact supporting Illinois' position and not in plaintiff's favor: "the ZEC program exclusively regulates separate sales of credits that represent environmental benefits of nuclear power generation and it does not regulate the rate or transaction of terms of wholesale power." Order at 29. The Order finds, "the ZEC program does not *mandate* auction clearing in PJM or MISO" and "is not imposing a condition directly on wholesale transactions" [emphasis in original]. Order at 30–31. The Order finds, "the 'tether' in this case is not to wholesale participation or transactional pricing; the tether is to broader, indirect wholesale market forces." Order at 31. Such finding is contrary to the facts, and is inappropriate at this stage of the proceeding because it makes a finding of fact that is not in plaintiff's favor. The concept of "indirect wholesale market forces" is not defined.

There is no such thing in this case. The ZECs Subsidies Program is directed at wholesale market prices.

The Order also makes improper findings of fact on other issues. For example, the finding that ZECs "represent environmental benefits of nuclear power generation" is a finding of fact that Plaintiffs challenge with contrary evidence. *Id.*; *see* Complaint at paras. 57–61. The Court finds that "RECs are similar to ZECs." Order at 32. Plaintiffs provide evidence that materially distinguish state renewable energy credits (RECs) from ZECs. Complaint at paras. 50–53.

The explicit purpose of the ZECs Subsidies Program is to reverse the outcome of the PJM wholesale power market. Competition in the PJM wholesale power market has resulted in lower prices. The identified nuclear power plant received a clear signal from the PJM wholesale power market, according to Exelon, that it was no longer economic at the lower, competitive wholesale power prices. The ZECs Subsidies Program is designed to reverse the outcome of the wholesale power markets, guarantee a payment equal to the subsidy amount plus the current market price, and require the identified nuclear power plant to continue to operate. The tether is clear and unambiguous.

## II. The District Court Misapplies the Law Protecting Federal Jurisdiction Over Wholesale Energy Markets.

The Supreme Court's decision in *Hughes* is the controlling law in this case.[9] *Hughes* is the Supreme Court's last word on what state programs are preempted by federal regulation of wholesale markets. The facts and circumstances in *Hughes* are similar to and in some cases identical to the facts and circumstances here. *Hughes* specifically concerns federal regulation as it affects the PJM wholesale power market. *Hughes* concerns the same fundamental issue that this case presents: whether a state program that disregards wholesale rates required by FERC (including in PJM) and is tethered to the FERC regulated markets is preempted. *Hughes* found that such state programs are preempted.

The ZEC Subsidies Program should be found preempted consistent with *Hughes* because the holding in *Hughes* squarely applies. Even if it did not, the ZEC Subsidies Program should still be found preempted consistent with the fundamental rationale in *Hughes*.

The Order improperly looks past *Hughes* to prior decisions that upheld state programs because the effects on federal regulation were determined to be targeted at

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[9] *See also PPL EnergyPlus, LLC v. Solomon*, 766 F.3d 241 (3d Cir. 2014) (finding a New Jersey program that subsidized new entry preempted under circumstances nearly identical to *Hughes*).

matters properly within the scope of state authority and determined not to be targeted at wholesale rate regulation. Those cases found that the effects on the federally regulated wholesale rates were incidental and indirect. The facts in those cases are distinguishable from the facts and circumstances of this case and *Hughes*. To the extent that older cases conflict with *Hughes*, *Hughes* is controlling. The District Court either improperly ignores *Hughes* or it interprets the decision unduly narrowly and without regard to its logic and its impact on prior decisions.

*Hughes* found the state program preempted because it "disregards an interstate wholesale rate required by FERC" and receipt of the subsidy was tethered to "wholesale market participation." *Hughes* at 1299. The policy rationale for state action did not matter in *Hughes*. *See Hughes* at 1298 ("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.") *Hughes* held that when a state program "disregards an interstate wholesale rate required by FERC" and receipt of the subsidy is tethered to "wholesale market participation," there is sufficient basis for finding that the state program is preempted. *Hughes* at 1299.

The failure to properly apply *Hughes* stems partly from the failure to apply a straightforward reading of the Illinois statutory text. Even if the text were ambiguous, it is evident in the justification for the program that there is an unwillingness to accept the level of compensation the ZEC Units receive under FERC regulated rates. The statue

defines the target compensation as current market prices of $31.40 per MWh plus a subsidy of $16.50 per MWh. The amount of the subsidy decreases as market prices increase so as to maintain a constant level of compensation. 20 ILCS 3855 § 1-75(d-5)(1)(B). The goal of the ZEC Subsidies Program is to set the level of compensation for the energy from two nuclear power plants that rely on the wholesale power market for compensation. Illinois is setting what it considers the just and reasonable price for wholesale power for these units. That is a FERC decision.

By artificially offsetting the outcome of the wholesale power market, the program is designed to keep the defined units operating. The energy from these plants will suppress the wholesale price of energy, affecting the market outcome for all other power plants.

There is no material difference in wholesale power market impact between subsidies for uneconomic entry (*Hughes*) and subsidies for uneconomic avoidance of exit (this case). *See Hughes* at 1293 ("The capacity auction serves to identify need for new generation: A high clearing price in the capacity auction encourages new generators to enter the market, increasing supply and thereby lowering the clearing price in same-day and next-day auctions three years' hence; a low clearing price discourages new entry and encourages retirement of existing high-cost generators."). There is no material difference between a requirement that a nuclear plant "operate" to receive subsidies and a requirement that a combined cycle plant clear capacity in an auction in order to

receive subsidies. *Id*. In both cases, there is a market participation requirement. There is no material difference between providing a subsidy directly linked to the interstate wholesale capacity market (*Hughes*) and providing a subsidy directly linked to the interstate wholesale energy market (this case).

Revenues from the capacity market and the energy market together create the opportunity for the recovery of the costs of generating plants. These are markets. When competitive prices result in units becoming uneconomic, the units exit the market. Between 2011 and 2020, 29,057.5 MW of generating unit capacity have retired or are scheduled to retire in the PJM market as a result of competitive forces.[10] Subsidies received under the ZEC Subsidies Program are specifically calibrated to avoid that result for the ZEC Units.

The ZEC Units are nuclear units, which cannot operate in a manner that avoids wholesale sales and use of the interstate transmission network. The units involved in the *Hughes* case were combined cycle units (CCs). Relative to nuclear units, CCs require less capital investment per MW and can increase or decrease output in response to prices. Capacity market revenues are a larger share of total revenues for CCs than for nuclear units. Energy market revenues are a larger share of total revenues for nuclear

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[10] *See* Monitoring Analytics, LLC, 2016 State of the Market Report for PJM, Vol II. (March 9, 2017) at 497–98.

units than for CCs. The subsidies in this case are energy market revenues tied to the production of energy and defined as the shortfall of desired revenues compared to the revenues from both energy and capacity markets. The state subsidies in *Hughes* focused on the capacity market, but the energy market and the capacity market are designed to work together to provide incentives to generating units. The state subsidies in *Hughes* affected wholesale energy prices as well as capacity prices. There is no material difference between the way wholesale prices in PJM were targeted in *Hughes* and the way wholesale prices in PJM are targeted in this case. The law establishing the kinds of state action that constitute preemption in *Hughes* must be consistently applied across different unit types. The goal of the subsidies in both cases is to achieve a target level of revenue for the subsidized units so that they are not dependent on wholesale power market prices.

*Hughes*' finding of preemption is consistent with and complements earlier Supreme Court cases that did not find preemption. In *Oneok*, and in *Northwest Central*, on which *Oneok* relies, the Supreme Court found that state action was not preempted. *Oneok*'s finding was based on a determination that state action "was not *aimed directly at* wholesale sales" and was aimed at "subjects left to the States to regulate" [emphasis in original]. *Oneok* at 1599–1600. *Northwest Central's* finding was based on a determination that state action applied to natural gas production and gathering, subject matter

reserved to the states, and was "designed as a counterweight to market, contractual, and regulatory forces."

The Order misreads the reference in *Northwest Central* to "market … and regulatory forces."[11] In *Northwest Central*, FERC was not relying on the indicated market forces to perform a regulatory function. In this case it is. The market forces with which the ZEC Subsidies Program interferes are not just general external market forces that alter the economics of operating the ZEC Units. The market forces with which Illinois seeks to interfere are the core mechanism that FERC is relying on to set just and reasonable prices through competition. *Northwest Central* predates *Hughes* and predates the competitive wholesale power markets that resulted from electric industry restructuring. *Northwest Central* stands for the proposition that FERC could not regulate factors that influence the wholesale rate, not that FERC cannot regulate the wholesale rate itself. Order at 24–26. No party in this case argues that state regulation of costs that indirectly influence the level of a wholesale rate is preempted. The issue here is whether a state can determine if a wholesale rate is too low or too high and impose a different one. Evidence that a state program operates in this way is a tether, which includes a

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[11] The Order focuses on Northwest's upholding of state regulation "[d]esigned as a counterweight to market, contractual and regulatory forces" even though "purchaser' cost and hence rates might be affected." Order at 25, citing Northwest at 514. The Order concludes, "Although the ZEC program will affect wholesale electricity rates, those rate were not its target."

requirement to participate in the markets and/or a mechanism to define the level of the wholesale rate received by the targeted units. Both elements are present in this case.

The District Court reserves most of its analysis for *FERC v. EPSA*, 136 S. Ct. 760 (2016), the case that in both fact and law is least related to the circumstances in this case. EPSA concerned whether FERC is intruding on the regulation of retail rates, which FPA reserves to the states.[12] The District Court finds that "[r]ead together, *EPSA* and *Hughes* stand for the proposition that preemption applies whenever a tether to wholesale rates is indistinguishable from a direct effect on wholesale rates." Order at 31–32.

What *EPSA* and *Hughes* actually say together is explained by the Supreme Court:

> Doubting FERC's judgment, Maryland—through the contract for differences—requires CPV to participate in the PJM capacity auction, but guarantees CPV a rate distinct from the clearing price for its interstate sales of capacity to PJM. By adjusting an interstate wholesale rate, Maryland's program invades FERC's regulatory turf. *See EPSA*, … 136 S. Ct. 760… ("The FPA leaves no room either for direct state regulation of the prices of interstate wholesales *or for*

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[12] *See* 16 U.S.C. § 824(b)(1).

> *regulation that would indirectly achieve the same result*." (internal quotation marks omitted)).[n9: According to Maryland and CPV, the payments guaranteed under Maryland's program are consideration for CPV's compliance with various state-imposed conditions, i.e., the requirements that CPV build a certain type of generator, at a particular location, that would produce a certain amount of electricity over a particular period of time. The payments, Maryland and CPV continue, are therefore separate from the rate CPV receives for its wholesale sales of capacity to PJM. But because the payments are conditioned on CPV's capacity clearing the auction—and, accordingly, on CPV selling that capacity to PJM—the payments are certainly "received . . . in connection with" interstate wholesale sales to PJM. 16 U. S. C. §824d(a).” [emphasis added]

The Supreme Court’s reasoning applies directly to this case. The words of the Supreme Court could easily apply to the facts in this case: Doubting FERC's judgment, Illinois—through the per MWh subsidy which is equivalent to a contract for differences—requires Quad Cities to participate in the PJM energy market, but guarantees Quad Cities a rate distinct from the clearing price for its interstate sales of

energy to PJM. By adjusting an interstate wholesale rate, the Illinois program invades FERC's regulatory turf.

The test in *Hughes* is also failed in this case. As in Hughes, the ZEC legislation guarantees a rate distinct from the clearing price for its interstate sales of energy to PJM.

A state program that purports to pay suppliers for some service other than energy but is explicitly contingent on the sales of energy in the wholesale market and explicitly tied to the level of the wholesale energy price and explicitly tied to the supplier's compensation is preempted under *EPSA*/*Hughes*.

The ZEC Subsidies Program requires the ZEC Units to operate and to sell power in the wholesale power markets and pays them based on the level of prices in the wholesale power market. *See* 20 ILCS 3855 § 1-5(d-5)(1)(b). This is a contract for differences. The higher the market prices, the lower the subsidy, until the subsidy reaches zero. If ZECs really were compensation for reduced carbon emissions service considered apart from energy prices, then the ZEC Units would receive the same compensation regardless of the level of wholesale energy market prices.

## III. FERC and PJM Rely on Competitive Wholesale Power Markets to Produce Just and Reasonable Rates.

### A. State Subsidies Targeting Wholesale Market Rates Undermine FERC's Regulatory Approach.

FERC declined the invitation of the District Court to directly present its views on the complaint.[13] However, in response to a similar request from the Supreme Court, FERC stated its position:

> If a state-supported bid clears the auction market when it would not have done so without the state support, another unsupported bid (which otherwise would have cleared) may not clear. And lower market-clearing prices that result from the state-supported generators' participation affect all participants in the PJM market and suppress the price signals that would otherwise indicate a need for new capacity… [B]y requiring the selected generators to bid their capacity into and clear the Commission-approved PJM auction, the programs directly interfere with the competitive

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[13] In declining to respond, the FERC explained that a complaint pending in Docket No. EL17-49-000 relates to the ZEC Subsidies Program and its lack of a quorum prevented action on the complaint. The complaint proceeding includes a proposed expansion of MOPR to address subsidies for existing units. *See* District Court ECF Document No. 91.

> market mechanisms that the auction uses to set wholesale capacity rates… In *Oneok*, the Court … explained that whether a state regulation falls within the preempted field depends on 'the target at which the state law aims.' [citation omitted]. The Court concluded that, unlike state regulations that are 'aimed directly at * * * wholesales for resale,' [citation omitted], the plaintiffs' state antitrust claims were not preempted because antitrust laws "are not aimed at natural-gas companies in particular, but rather all businesses in the marketplace…[14]

The Market Monitor does not speak for FERC, but it was created by FERC to monitor "[s]tructural problems in the PJM Markets that may inhibit a robust and competitive market." OATT Attachment M § IV.B.3. Subsidies designed to forestall the exit of units in response to market signals have the same impact on wholesale power markets as subsidies designed to create new entry. If programs like the ZEC Subsidies Program are not preempted, they will eventually preempt regulation through competition. By suppressing the price of energy, the ZEC Subsidies Program will make

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[14] Brief of the United States as Amicus Curiae, U.S. S. Ct. Case No. 14-614 (September 2015).

other nuclear plants less economic, leading to further requests for subsidies. If successful in Illinois, Exelon will seek subsidies for nuclear plants elsewhere in PJM.[15] If Exelon is successful in Illinois, the impact will be to reduce energy prices in the wholesale power market below the competitive level and provide a rationale for Exelon and the owners of other nuclear power plants to seek subsidies for additional nuclear power plants. Exelon owns 16 and partially owns an additional four, and so has an ownership interest in 20 out of 32 nuclear power plants in PJM. Subsidies are contagious. As the effect grows and the negative impact on energy market prices is amplified, this will lead to requests for subsidies for coal plants and eventually gas plants. The PJM market design is especially sensitive to such impacts because the PJM market design relies entirely on competitive markets to provide price signals to investors in existing plants and to investors considering entering the market.

Because the outcome of court cases challenging state subsidies like the ZEC Subsidies Program are uncertain, FERC must consider expanding its existing rules against subsidies for new units to address subsidies for existing units in order to

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[15] *See* Exelon, Exelon to Retire Three Mile Island Generating Station in 2019, which can be accessed at <*http://www.exeloncorp.com/newsroom/exelon-to-retire-three-mile-island-generating-station-in-2019*> (May 30, 2017) ("Exelon Corporation today said it will prematurely retire its Three Mile Island Generating Station (TMI) on or about September 30, 2019, absent needed policy reforms.").

preserve competitive market outcomes. Currently, there are at least two proceedings before the FERC where the agency is confronting the issue of how the markets can be protected against intrusive state actions. In a complaint proceeding initially filed in response to a proposal that Ohio subsidize economically distressed coal units, that was later expanded to include the ZEC Subsidies Program, the FERC is considering expanding the Minimum Offer Price Rule (MOPR) so that it also covers subsidies for existing units, such as the ZEC units.[16] The MOPR in its current form (the same PJM market rule discussed in *Hughes* at 1298 & n.11) only addresses subsidies for new gas fired units. FERC has also initiated a rulemaking to consider how to address the issue at the national level.[17]

That defensive rules are under consideration is not a basis to determine that the there is no preemption. That FERC proceedings are underway to address subsidies for existing units in addition to new units constitutes evidence that the ZEC Subsidies Program intrudes on FERC regulatory authority and should be preempted by such authority. If there were no intrusion, then no defensive rule would be needed. The discussions at FERC have also illustrated that is difficult if not impossible to create

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16 *See*, *e.g.*, Comments of the Independent Market Monitor for PJM, FERC Docket No. EL16-49-000 (April 11, 2016); PJM OATT Attachment DD § 5.14(h).

17 *See State Policies and Wholesale Markets Operated by ISO New England Inc., New York Independent System Operator, Inc., and PJM Interconnection, L.L.C.*, Notice of Technical Conference, FERC Docket No. AD17-11-000 (March 3, 2017).

market rules to fully offset the impact of subsidies and retain wholesale market prices based on competitive market fundamentals. The FERC should not have to engage in the lengthy processes underway in an effort to offset the ZEC Subsidies Programs and other state subsidy schemes.

The District Court refuses to find that the "ZEC program does 'clear damage' to FERC's goals." Order at 34. The District Court states, "The market distortion caused by subsidizing nuclear power can be addressed by FERC and the interplay between state and federal regulation can continue to exist." *Id*. The District Court has it backwards.

In *Hughes*, the Supreme Court agreed with FERC that "requiring the selected generators to bid their capacity into and clear the Commission-approved PJM auction, the programs directly interfere with the competitive market mechanisms."[18] Moreover, *Hughes* plainly states that FERC is not required to develop rules to protect its regulatory approach from interference. *Hughes* held that preemption doctrine protects the exclusive jurisdiction of the Commission, explaining "Maryland cannot regulate in a domain Congress assigned to FERC and then require FERC to accommodate Maryland's intrusion" (citing *Northwest Central* at 518 ("The NGA does not require

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[18] *Hughes* at 1299 ("We reject Maryland's program only because it disregards an interstate wholesale rate required by FERC. … So long as a State does not condition payment of funds on capacity clearing the auction, the State's program would not suffer from the fatal defect that renders Maryland's program unacceptable.").

FERC to regulate around a state rule the only purpose of which is to influence purchasing decisions…"). *Hughes* at 1298 n.11. The "market distortion" that the District Court concedes exists (Order at 34) "caused by subsidizing nuclear power" must be eliminated by finding the subsidies program preempted.

### B. The ZEC Subsidies Program Is a Threat to PJM's Market Design Because PJM's Market Design Relies on Competitive Investment.

Both PJM and MISO are RTOs. PJM and MISO operate in different parts of Illinois. PJM and MISO both submitted briefs of amicus curiae to the District Court, but the RTOs offered very different views on the potential effects of the ZEC Subsidies Program.[19]

In support of EPSA, PJM states:

> [T]he … ZEC… program … will substantially harm the wholesale electricity markets that PJM operates, as well as the investors, competitive energy providers, and (ultimately) consumers that rely on PJM's markets to provide adequate and reliable electricity at the lowest efficient price.

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[19] *Cf*. Brief of PJM Interconnection, L.L.C. as Amicus Curiae in Opposition to Motions to Dismiss, USDC N. Dist. of Ill. Case No. 1:17-cv-01164, Doc. #107 (July 14, 2017) ("PJM Brief"); Midcontinent Independent System Operator, Inc.'s Brief as Amicus Curiae in Support of Defendants' Motion to Dismiss, USDC N. Dist. of Ill. Case No. 1:17-cv-01164, Doc. #85-1 (April 24, 2017) ("MISO Brief").

> Moreover, the ZEC program will frustrate Congress' intent to promote competition in wholesale electricity markets and, in particular, thwart Congress' assignment to the … FERC … of responsibility to set just and reasonable wholesale electricity rates under the Federal Power Act.[20]

In support of Illinois, MISO states:

> MISO's programs and requirements *are complementary* to any state-approved mechanisms. [footnote omitted] Specifically, MISO's resource adequacy and market mechanisms should not affect nor alter state actions over entities under state jurisdiction" [emphasis in original].[21]

The different views reflect fundamental differences in the two market designs. The intrusion on FERC regulations that established the PJM market design is more severe for PJM. It is significant that both *Hughes* and this case concern the regulatory approach adopted for the PJM region, and not other regions of the country that are regulated under different approaches.

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[20] PJM Brief at 1.

[21] MISO Brief at 16–17.

PJM is a competitive interstate wholesale power market, designed to remove investment risk from customers and assign it to competitive investors. In PJM, merchant generators rely solely on the market for revenues. PJM relies upon competitive investment by merchant generators to meet load and to replace retiring generating units.

MISO does not rely on competitive investment. MISO's "market mechanisms" are effectively a power pool, an arrangement that facilitates efficient dispatch but does not rely on markets to incent entry and exit. PJM was a power pool prior to the creation of a wholesale power market in 1998. The MISO model continues to rely on the old regulatory regime of state regulated cost of service rates to ensure adequate revenue to existing and new units and engage in regulatory planning to determine the need for new units. In MISO, most generators do not rely on wholesale power markets for the revenue required to incent continued investment, new market entry or market exit. Investment in MISO is generally the result of state decisions and not of merchant generators responding to competitive market signals.

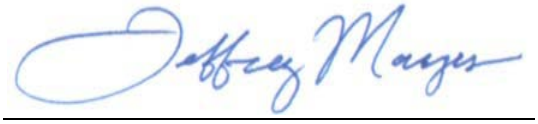
MISO can afford to be indifferent to the effects of the ZEC Subsidies Program because does not rely on competitive investment. PJM relies on competitive investment and cannot be indifferent.

## CONCLUSION

The Market Monitor respectfully requests that the court consider the arguments raised on brief and reverse the Order.

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Respectfully submitted,



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**CERTIFICATE OF SERVICE**

I hereby certify that, on September 5, 2017, the above motion was filed with the Clerk of Court, who will enter it into the CM/ECF system, which will send a notification of such filing (NEF) to the appropriate counsel.



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