Nos. 14-614 & 14-623

IN THE

Supreme Court of the United States

W. KEVIN HUGHES, *ET AL.*,
Petitioners,
v.
PPL ENERGYPLUS, LLC, *ET AL.*,
Respondents.

CPV MARYLAND, LLC,
Petitioner,
v.
PPL ENERGYPLUS, LLC, *ET AL.*,
Respondents.

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

BRIEF OF NRG ENERGY, INC., AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

1. Is a State's effort to facilitate the construction and operation of a needed power plant by directing a competitive procurement and by directing its local utilities to enter into a long-term contract with the winning developer at the developer's competitively bid price "field preempted" by the Federal Power Act as a State's attempt to set interstate wholesale rates?

2. Is a state-directed, competitively procured contract to support construction of a power plant "conflict preempted" because its long-term pricing structure provides incentives for that construction different from the "price signals" generated by a FERC-supervised yearly forward capacity auction?

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BRIEF OF NRG ENERGY, INC., AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF *AMICUS CURIAE*

NRG Energy, Inc. ("NRG") is one of the largest power generation and retail electricity businesses in the United States.[1] NRG owns and operates over 50,000

[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus curiae* states that no counsel for a party authored this brief in whole or in part or made a monetary contribution to the preparation and

megawatts of generation capacity, including 16,000 megawatts of merchant generation in the 13-State region overseen by PJM Interconnection, LLC ("PJM"). NRG also purchases and markets energy and energy-related products, including power, natural gas, and renewable energy. And it provides electricity to 3 million retail customers in Texas and nine northeastern States, including six States within PJM's footprint.

NRG and its affiliates have invested billions of dollars in both conventional and renewable generation facilities. Many of these investments are supported by state-mandated contracts, while others are made on a merchant basis (*i.e.*, without contracts or other recourse to captive ratepayers). Because NRG often relies on state contracts when it invests in generation facilities, it has an interest in preserving their integrity and viability. NRG also invests based on price signals sent by federally regulated wholesale markets. Accordingly, it has an interest in ensuring that market prices are not artificially depressed or distorted—whether due to the exercise of market power or state-sponsored contracts. NRG thus has both an interest in and a balanced perspective on these cases, which concern whether federal law preempts state contracts that support the development of generation. In NRG's view, these interests all can be harmonized through the proper exercise of federal regulatory authority. By contrast, a policy of preemption by judicial decree harms all of them.

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submission of this brief, and no person other than *amicus* or its counsel made such a contribution. All parties consented to the filing of this brief. Copies of the letters granting consent have been filed with the Clerk.

STATEMENT

Since 1935, the Federal Power Act ("FPA") has afforded the Federal Energy Regulatory Commission ("FERC" or the "Commission") and its predecessor exclusive jurisdiction to regulate wholesale energy sales in interstate commerce. But States retain the broad authority they exercised before the FPA. That authority encompasses a variety of state policies that affect or require new power-plant construction and financing. Such exercises of traditional state authority—including the development of capacity for the benefit of local utilities—may impact wholesale markets, where FERC has exclusive jurisdiction. But FERC has ample authority to regulate wholesale markets—and conduct in those markets—to prevent adverse impacts without preempting traditional state authority.

For example, FERC has exercised regulatory authority over federal wholesale auctions to ensure prices are not distorted by below-cost or other non-market bidding. In particular, FERC has acted directly on the wholesale auctions that are within its regulatory domain, approving rules designed to preclude bids (regardless of source) that might distort pricing. Such rules, properly calibrated and applied, can harmonize the exercise of state and federal authority: States act within their domain to promote generation that benefits their citizens, while FERC acts within its domain to ensure that state or private action does not result in unjust or unreasonable wholesale rates. Efforts to preempt state action, by contrast, lack that harmonizing effect. Rather than protect state and federal authority within their respective zones, they elevate one set of interests above the other. They intrude unnecessarily into traditional state authority. They invite litigants to seek case-by-case

judicial preemption to remedy the effects of specific contracts instead of pursuing more efficient and tailored remedies before FERC. And they discourage FERC—the expert body to which Congress delegated responsibility for regulating federal markets—from fulfilling its statutory mission by ensuring its market rules produce just-and-reasonable rates.

I. STATUTORY AND REGULATORY BACKGROUND

A. Early Energy Markets

The first electric utilities formed shortly after Thomas Edison invented a commercially viable lightbulb in 1879. Stephen L. Teichler & Ilia Levitine, *Long-Term Power Purchase Agreements in a Restructured Electricity Industry*, 40 Wake Forest L. Rev. 677, 679-680 (2005).[2] Those utilities typically operated as vertically integrated monopolies. For any given region, the same company controlled electric generation (plants to create electricity), transmission (facilities and lines to transport it), and retail or local distribution to customers. *Id.* at 679-680 & n.9.

Initially, state legislatures and municipalities regulated utilities themselves. Robert Swartwout, *Current Utility Regulatory Practice from a Historical Perspective*, 32 Nat. Res. J. 289, 298-301 (1992). Legislatures set rates by statute, and municipalities issued franchises. *Ibid.* By 1920, however, nearly every State had delegated regulatory responsibility to state public utility commissions, *id.* at 301, which exercised "authority to franchise the utilities; to regulate their rates, financing,

[2] Utilities that provide power to customers in retail markets are often called "Load-Serving Entities." For ease, however, this brief uses the term "utility."

and service; and to establish utility accounting systems," Teichler & Levitine, *supra*, at 679 & n.8.

Wholesale transactions burgeoned. Municipalities and utilities sometimes found it cheaper to buy electricity to meet peak demand than to build more plants; consequently, they entered into long-term requirements contracts for bundled sales of generation and transmission. Teichler & Levitine, *supra*, at 680. Most transactions were intrastate. Dozier A. DeVane, *Highlights of Legislative History of the Federal Power Act of 1935 and the Natural Gas Act of 1938*, 14 Geo. Wash. L. Rev. 30, 31 (1945). However, in 1927, three east-coast utilities formed a power pool—an arrangement for sharing electricity—that eventually developed into the Pennsylvania-New Jersey-Maryland Interconnection. See FERC, *Energy Primer: A Handbook of Energy Market Basics* 36-37 (July 2015); Teichler & Levitine, *supra*, at 680 & n.11. Between 1928 and 1933, the share of electricity for public consumption that moved interstate grew from 10.07% to 17.8%. DeVane, *supra*, at 31.

B. The Federal Power Act

As interstate electricity sales proliferated, so did state attempts to regulate them.[3] In *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927), this Court ended the regulatory efforts, overturning a state order that had modified a wholesale contract for electricity between a Rhode Island generator and a Massachusetts utility. See *id.* at 85-86. The Court declared that the order placed a "direct burden upon interstate commerce," and ruled that the Commerce

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[3] See, *e.g.*, *People's Nat. Gas Co.* v. *Pub. Serv. Comm'n*, 270 U.S. 550, 551-553 (1926); *Missouri ex rel. Barrett* v. *Kan. Nat. Gas Co.*, 265 U.S. 298, 305-306 (1924).

Clause precluded the state commission from exercising authority over the wholesale contract. *Id.* at 89-90.

In response, Congress enacted the Federal Power Act of 1935, Pub. L. No. 74-333, 49 Stat. 847. *New England Co.* v. *New Hampshire*, 455 U.S. 331, 340-341 (1982). The Act created a federal regulator, the Federal Power Commission (now FERC), with exclusive authority to regulate the transmission or sale "of electric energy at wholesale in interstate commerce." 16 U.S.C. §824(b). Under the Act, every public utility must file wholesale rates with FERC, *id.* §824d(c), which must ensure that they are "just and reasonable," *id.* §824d(a); see also *id.* §§824d(e), 824e(a).

The FPA, however, makes clear that federal authority over electricity markets "extend[s] only to those matters which are not subject to regulation by the States." 16 U.S.C. §824(a). States thus continued to regulate power-plant construction and siting, requiring utilities to apply for certificates of public convenience and necessity before building them. See *Pac. Gas & Elec. Co.* v. *State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 205-207, 212 (1983). Through those processes, state commissions could determine the mix of generation resources (gas, coal, nuclear) utilities would build and how their power would be distributed. See *New York* v. *FERC*, 535 U.S. 1, 24 (2002). And States continued to regulate retail rates, see 16 U.S.C. §824(b)(1), adjusting them to provide appropriate compensation and incentives, Swartwout, *supra*, at 304-305.

The FPA mandates respect for private contracts for interstate sales of electricity. Under the *Mobile-Sierra* doctrine—named for this Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348

(1956)—FERC must "presume that the rate set out in a freely negotiated wholesale-energy contract meets the 'just and reasonable' requirement imposed by law." *Morgan Stanley Capital Grp. Inc.* v. *Pub. Util. Dist. No. 1*, 554 U.S. 527, 530 (2008). That "presumption may be overcome only if FERC concludes that the contract seriously harms the public interest," a finding that cannot be made absent "'unequivocal public necessity' or 'extraordinary circumstances.'" *Id.* at 550 (citation omitted).

C. FERC's Restructuring of Wholesale Markets

In the 1990s, many States undertook reforms to make utilities more efficient while maintaining them as vertically integrated monopolies. See Kathleen Spees, *et al.*, *Enhancing the Efficiency of Resource Adequacy Planning and Procurements in the Midcontinent ISO Footprint* 21-22 (Nov. 2015). FERC and a minority of States implemented market-based reforms. See U.S. Energy Information Administration, *Status of Electricity Restructuring by State* (Sept. 2010), http://goo.gl/3bcGQT. This case has its origins in FERC's efforts to restructure wholesale energy markets and to increase their efficiency—and ensure just-and-reasonable rates—by promoting effective competition. *Midwest ISO Transmission Owners* v. *FERC*, 373 F.3d 1361, 1363 (D.C. Cir. 2004).

1. *The Development of Regional Markets and Minimum-Offer-Price Rules (MOPRs)*

A key element of FERC's reforms was "the development of multi-utility regional transmission organizations (RTOs)." *Midwest ISO*, 373 F.3d at 1364. Before FERC's reforms, the electric grid was segmented among different local utilities. *Ibid.* Now, in much of the Nation, utilities may join an RTO that interconnects "different segments" of the grid owned by member utili-

ties, offering "open access to the regional transmission system" for "all electricity generators" under a non-discriminatory, "'unbundled, grid-wide tariff.'" *Ibid.* (quoting Order No. 888, at 31,731).

PJM Interconnection, LLC ("PJM") is the largest RTO. It spans 13 States (plus the District of Columbia) and operates the world's largest wholesale electricity market. PJM, *PJM Markets* 1 (May 14, 2015), https://goo.gl/MV05KI. Subject to FERC's authority to ensure just-and-reasonable rates, see *Reg'l Transmission Org.*, 89 FERC ¶61,285, at 5 (1999), PJM runs a spot market in which energy is bought and sold on a minute-by-minute basis for immediate consumption. PJM, *supra*, at 1.

PJM also operates a forward market for another energy product, capacity. Capacity is the *ability* to supply electricity when needed. *Conn. Dep't of Pub. Util. Control* v. *FERC*, 569 F.3d 477, 479 (D.C. Cir. 2009). Utilities buy capacity—"an option to buy a quantity of electricity"—to ensure energy is available to meet periods of peak demand. *NRG Power Mktg., LLC* v. *Me. Pub. Utils. Comm'n*, 558 U.S. 165, 168 (2010); see also *Conn. Dep't of Pub. Util.*, 569 F.3d at 479. Because generators need lead-time to build plants that will supply capacity, PJM's capacity auctions occur three years ahead of scheduled delivery. PJM, *supra*, at 1-2.

By efficiently matching supply and demand, these auctions seek to keep prices competitive while ensuring investment in new capacity sufficient to meet future needs. *PJM Interconnection, L.L.C.*, 137 FERC ¶61,145, at ¶¶2, 96 (2011). Because demand is relatively inelastic, market prices for capacity are highly sensitive to changes in supply or demand. *Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity & Ancillary Servs. by Pub. Utils.*, 123 FERC ¶61,055, at ¶¶37-38

(2008). FERC has therefore repeatedly addressed capacity market rules, and the possible exercise of buyer or seller market power, to fulfill its obligation to secure just-and-reasonable rates. See, *e.g.*, *PJM Interconnection, L.L.C.*, 153 FERC ¶61,066 (2015); *PJM Interconnection, L.L.C.*, 137 FERC ¶61,145; *ISO New England, Inc.*, 135 FERC ¶61,029 (2011).

One issue has been "uneconomic entry"—the concern that States or utilities may find it in their interest to bring additional capacity into the market at below-market rates. The combination of excess supply and lower bids can significantly depress prices, interfering with the auction's ability to produce just-and-reasonable rates. *PJM Interconnection, L.L.C.*, 137 FERC at ¶96; see also *New England Power Generators Ass'n, Inc.* v. *FERC*, 757 F.3d 283, 287 (D.C. Cir. 2014).[4]

To prevent that, PJM applies a rule, called the "minimum-offer-price rule." Under it, PJM will adjust a new entrant's offer to a market-rate if PJM finds the offer to be uneconomic. *PJM Interconnection, L.L.C.*, 135 FERC ¶61,022, at 61,088 (2011). By focusing on conduct within federally regulated markets, those rules foster efficient markets while "accommodat[ing] * * * legitimate state policy objectives." *New England States Comm. on Elec.* v. *ISO New England Inc.*, 142 FERC

[4] Capacity suppliers offer their capacity into PJM's auction. PJM builds a "supply curve" of all offers and determines where that curve crosses an administratively-determined demand curve to establish the auction clearing price, which is paid to all suppliers that "clear" the auction. Buyers can actually profit by selling into the auctions below cost if the resulting price decrease, multiplied by the buyer's total purchase obligation, exceeds losses from the below-cost bid. PJM's minimum-offer-price rule is intended to correct that problem by requiring that bids reflect the actual costs of building capacity and entering the market.

¶61,108, at 61,488 (2013); see also *PJM Interconnection, L.L.C.*, 143 FERC ¶61,090, at ¶54 (2013).

Market participants and affected entities regularly challenge PJM rules they consider imperfect. See, *e.g.*, *PJM Interconnection, L.L.C.*, 135 FERC ¶61,022, at ¶¶8-12 (2011); *ISO New England, Inc.*, 131 FERC ¶61,065, at ¶¶10-12 (2010). When PJM proposes a rule, interested parties may file a protest objecting to the rule or any other element of auction design. See 16 U.S.C. §§824d(e), 824e(a), 825e; 18 C.F.R. §385.211.

2. *Bilateral Contracts and State Initiatives*

Alongside those organized markets, utilities and States still procure capacity and energy directly from generators—*i.e.*, through bilateral contracts. FERC, *supra*, at 56-57. Energy and capacity markets depend heavily on bilateral contracts, which provide developers a low-cost means of attracting capital for new power plants, and allowing existing generators to sell power at predictable prices. American Public Power Association, *Power Plants Are Not Built on Spec: 2014 Update* 1 (2014); Teichler & Levitine, *supra*, at 690-691. Building a power plant requires extensive capital outlays—in the hundreds of millions of dollars—that take years to recoup. Sidney A. Shapiro & Joseph P. Tomain, *Rethinking Reform of Electricity Markets*, 40 Wake Forest L. Rev. 497, 505 (2005). To offset costs and minimize risks, developers sell energy and capacity under long-term bilateral contracts, "guaranteeing that * * * sufficient revenues will be forthcoming regardless of market conditions." Ezra Hausman, *et al.*, *Bilateral Contracting in Deregulated Electricity Markets: A Report to the American Public Power Association* 16 (Apr. 18, 2008). In the majority of States that have not restructured their energy markets, long-term bilateral

contracts remain "the single most essential requirement" for procuring new capacity. *Midwest Indep. Trans. Sys. Operator, Inc.*, 109 FERC ¶61,157, at 61,714 (2004).

Existing generators also use bilateral contracts to hedge against volatility. Because supply and demand are highly inelastic in wholesale markets (at least in the short term), spot-market prices can move "dramatically," jumping "more than fifteenfold" in a single summer. *Morgan Stanley*, 554 U.S. at 539. Most utilities and generators therefore apportion price-risk using a mix of bilateral contracts. Teichler & Levitine, *supra*, at 690-691. Basic contracts often call for delivery of power at fixed prices; more complex agreements resemble financial derivatives to provide "hedges" against volatility. See K. Cory, *et al.*, *Innovations in Wind and Solar PV Financing* 10 (Feb. 2008).

Even in restructured regions, States heavily influence the development of new generating capacity. State regulators can impose a variety of approval requirements on firms building new generation facilities. See, *e.g.*, *Miss. Power & Light Co.* v. *Miss. ex rel. Moore*, 487 U.S. 354, 358 (1988). Regulators can decide whether to authorize their construction, where they should be built, and even the fuel-type they use. See *New York*, 535 U.S. at 24.

States also provide direct incentives for energy development. The States offer at least 435 incentive programs for renewable energy alone. See N.C. Clean Energy Technology Center, *Programs*, DSIRE (2015), http://goo.gl/tJHJCP. California, for instance, has 14 different incentive programs: One requires utilities to source a certain amount of electricity from renewable generation; another provides state financing for renewable-energy projects; and a third awards renewable-energy generators favorable contracts with

utilities. See *ibid.* Most States have similar initiatives. See *ibid.* The costs of such programs are recovered through rates collected from retail customers.

II. PROCEEDINGS BELOW

A. The Maryland Generation Order

For most of the 20th century, Maryland utilities were vertically integrated monopolies. Pet. App. 11a. In 1999, however, Maryland deregulated its electricity market, requiring utilities to divest their generation resources. See Md. Code. Pub. Utils. § 7-501, *et seq.* Maryland utilities now purchase electricity on federal wholesale markets or through bilateral contracts. Pet. App. 11a; Md. Code. Pub. Utils. § 7-510(c)(4)(ii).

In 2008, the Maryland Public Service Commission ("MPSC") expressed concern that not enough capacity was being built in Maryland. Pet. App. 12a, 80a. The MPSC solicited proposals for the construction of up to 1,500 MW of new capacity. *Id.* at 12a, 87a. To mitigate the risks involved in that sort of commitment, the MPSC offered the winning bidder 20-year contracts for differences—a common type of financial instrument that transfers the risk of low prices (or the benefits of high ones) in spot markets from the generator to its counterparty, Cory, *supra*, at 10—with three Maryland utilities. Pet. App. 12a. The MPSC finalized its plan in the so-called Generation Order. *Ibid.*

Petitioner CPV submitted the winning bid. Pet. App. 12a. The resulting contracts required CPV to build a power plant that can provide capacity to Maryland utilities through wholesale capacity auctions. *Ibid.*[5] The

[5] PJM requires capacity suppliers in its region to "bid" their capacity into the market. Starting with the lowest bid, PJM matches the offers to forecasted demand. If a generator (such as CPV) has

contract-for-differences component provided protection from the sometimes volatile prices that come out of those auctions and made it easier for CPV to secure financing at competitive rates.[6] CPV was required to submit a bid that "cleared" (*i.e.*, was accepted) at auction. If the auction price fell below a specified threshold, the Maryland utilities would pay CPV the difference. *Id.* at 12a-13a. That shielded CPV from the risk of low capacity prices. Conversely, if the market price exceeded the contract price, CPV would pay the utilities the difference, protecting the utilities from the effects of higher capacity prices with respect to CPV-supplied capacity. J.A. 392, 396-397.

B. District Court Proceedings

Respondents—participants in PJM's auctions—filed this lawsuit. Pet. App. 13a. They alleged that the Generation Order intruded into FERC's authority to regulate wholesale markets. *Ibid.* They expressed concern that state-sponsored contracts would depress prices in federal capacity auctions. Dist. Ct. Compl. ¶¶67, 70, 73, 77-78. The district court held that federal law preempted the Generation Order. Pet. App. 129a. The court reasoned that CPV's contracts for differences "established" wholesale rates and thereby invaded FERC's exclusive domain. *Id.* at 113a. The court also "note[d]" that the

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agreed to supply energy to a utility in a bilateral contract, the generator and utility still participate in the auction, selling and buying through PJM. They settle the bilateral contract financially, so it acts as a hedge against auction prices for the amount of capacity covered by the contract.

[6] Over the last decade, capacity prices in the main PJM auction (the Base Residual Auction) have ranged from $110.06 per unit to $237.33 per unit—a difference of over 115%. See PJM, *2018/2019 RPM Base Residual Auction Results* 17 (2015).

Generation Order might be preempted under the doctrine of conflict preemption. *Id.* at 130a.

C. The Fourth Circuit's Decision

The Fourth Circuit affirmed. The Generation Order, it held, improperly supplanted FERC's exclusive power to regulate wholesale energy sales. Pet. App. 17a. The order intruded into that field as a "functional" matter, the court stated, because the rate CPV received under its contracts for differences replaced the "rates established through a FERC-approved" auction. *Id.* at 17a-19a. The court recognized that States might have authority to encourage generation through "direct subsidies or tax rebates, that may or may not differ in important ways from the Maryland initiative." *Id.* at 21a. But the court held the Generation Order preempted nonetheless because its "effect" on wholesale rates was "neither indirect nor incidental." *Ibid.*

The court stated that conflict-preemption principles reinforced its holding because the Generation Order "has the potential to seriously distort * * * price signals" in federal capacity markets. Pet. App. 21a-22a. At the time, FERC applied a minimum-offer-price rule to mitigate any distortion from state activities. *Id.* at 24a. But the court asserted that the rule's existence "confirm[ed] rather than refute[d] the existence of a conflict." *Ibid.* Finally, the court held that the Generation Order—which guaranteed CPV fixed rates for 20 years through bilateral contracts—amounted to a collateral attack on a FERC rule guaranteeing new generators fixed rates for three years. *Id.* at 23a-24a.

SUMMARY OF ARGUMENT

The Federal Power Act of 1935 created a new federal agency—vesting it with exclusive jurisdiction over whole-

sale sales of energy in interstate commerce—but otherwise left intact traditional State authority to regulate and promote the development of new generation resources. No observer in 1935 would have thought, as the courts below ruled, that States had been denied the ability to create incentives for the development of additional generation resources. To the contrary, both the States and the federal government retained critical roles. Harmonizing state and federal authority here requires calibrated federal regulation, not the blunt and often random impact of case-by-case federal preemption.

I. FERC has exclusive regulatory authority to ensure wholesale rates are just and reasonable. To fulfill that obligation, FERC reviews wholesale market designs to ensure they produce just-and-reasonable rates. With respect to federal auctions, moreover, FERC adopts targeted solutions to ensure uneconomic bids do not distort auction outcomes. Here, for example, FERC has approved a minimum-offer-price rule that, rather than attempt to prohibit States from promoting the development of generation resources, regulates how those efforts interface with federal auctions. In particular, by requiring bids to reflect costs, and foreclosing below-cost offers, the rule can ensure that uneconomic entry does not distort auction outcomes—without intruding into or invalidating state policies.

If that rule fails to work as intended, the answer is for FERC to alter its rules. Here, however, respondents—now joined by FERC's lawyers—instead defend a judicial decree voiding specific state-supported contracts. That reliance on federal preemption is troubling. It intrudes unnecessarily into state authority. It elevates one set of interests (efficient auction outcomes) over other equally important ones (state authority) despite the

availability of other solutions (such as more effective minimum-offer-price rules) that accommodate all interests. And it encourages complainants and FERC itself to address ongoing problems through case-by-case litigation rather than efficient and effective use of FERC's own authority.

II. In any event, the state order challenged here is not preempted. Under the FPA, States may not set wholesale rates; ensuring just-and-reasonable rates is FERC's obligation. States, however, have always engaged in activities that can influence wholesale rates. States can regulate the construction of new power plants; regulate financing; and provide incentives for new generation (including renewable resources). This Court has never held that States lack such authority simply because it has the potential to impact federal markets.

The feature of the state-sponsored contracts faulted below—the contract for differences—does not "set" federal wholesale rates. It functions as a hedge, insulating CPV against price volatility. Nor does its putative impact on federal auctions necessitate preemption. That is an impact FERC can (and should) address by better regulating its own wholesale markets. This case calls for thoughtful exercise of that authority, not the blunt instrument of federal preemption.

ARGUMENT

This case involves important interests on all sides. State regulation and state-sponsored contracts play a critical role in today's energy markets. States rely on contracts to ensure energy security for their citizens, promoting the development of new generation resources. Generators—competitive power suppliers and public utilities alike—rely on those contracts to make enormous, multi-year investments in new generation facilities, in-

cluding renewable resources and next-generation technologies like battery storage. The need for just-and-reasonable rates in federally regulated wholesale markets is no less imperative. An approach that abrogates any of those interests, even for the purpose of pursing others, invites energy-market anarchy that serves no interest well—not those of consumers, industry, or regulators.

Experience has taught *amicus* the importance of each of these interests. NRG understands first-hand the importance of state-sponsored generation contracts: It has invested billions of dollars in developing generation resources, including renewable resources, in reliance on state contracting authority. NRG likewise has experienced first-hand the necessity of properly functioning wholesale markets. NRG invests enormous sums in developing conventional and renewable resources where those markets are the only source of cost recovery. A seller of capacity and other energy products, NRG suffers when those markets—because of influences unredressed by market rules—fail to produce just-and-reasonable rates.

This case calls for the harmonization of those critical interests—not preemption that elevates one set of interests over the others. The FPA affords FERC ample authority to condition how the contracts here interact with federal markets. For example, FERC has approved the use of a "minimum-offer-price rule" designed to prevent uneconomic bids (whatever their source) from entering wholesale capacity auctions. Properly administered, that approach accommodates *both* state and federal authority: States may pursue their regulatory goals while FERC, by directly regulating the wholesale markets at the core of its authority, ensures that neither

those state policies nor other actions render wholesale-auction results unjust or unreasonable.

The judicial decree below preempting state authority substitutes a blunt remedy for that calibrated approach. It discourages FERC from fulfilling its duty of ensuring just-and-reasonable rates through its own regulatory efforts. And it cuts deeply and unnecessarily into an area of traditional—and important—state authority. It is also mistaken. No one at the time of the FPA's enactment in 1935 would have thought it deprived States of authority to create incentives for the development of new power plants. Nor does that theory make sense today.

I. THE COURTS BELOW SHOULD NOT HAVE ENTERTAINED THIS SUIT

Congress granted FERC the authority and duty to superintend wholesale electricity sales to ensure that wholesale rates remain "just and reasonable." 16 U.S.C. §824d(a). This case calls for the appropriate exercise of that authority to ensure the integrity of federal markets, without resort to preemptive decrees that intrude into the traditional state domain of promoting the development of generation resources.

A. This Action Should Have Proceeded Before FERC—Not in Federal Court—Because It Challenges the Terms of Energy Contracts

FERC has broad authority to ensure that wholesale rates are "just and reasonable." 16 U.S.C. §824d(a); see also *id.* §824e(a). Federal law requires every public utility to file its wholesale rates with FERC. *Id.* §824d(c). If FERC determines the rates are "unjust, unreasonable, unduly discriminatory or preferential," FERC may set them aside and modify them. *Id.* §824e(a); see also *id.* §824d(e). Similarly, FERC may review for unreason-

ableness "any rule, regulation, practice, or contract affecting" rates. *Id.* §824e(a). The Act thus gives FERC authority to modify published tariffs and, in exceptional circumstances, bilateral contracts. *NRG Power Mktg., LLC* v. *Me. Pub. Util. Comm'n*, 558 U.S. 165, 171-172 (2010).

FERC also exercises authority over the real-time energy markets and forward-looking capacity auctions operated by RTOs like PJM. Among other things, FERC must review and approve the rules governing those markets to ensure they produce just-and-reasonable rates. See, *e.g.*, *PJM Interconnection, L.L.C.*, 117 FERC ¶61,331, at 62,652 (2006). To that end, PJM—like other RTOs—imposes a minimum-offer-price rule (or "MOPR") to ensure that uneconomic bidding does not distort auction results. *PJM Interconnection, L.L.C.*, 135 FERC ¶61,022, at 61,088 (2011). FERC has addressed whether PJM's minimum-offer-price rule applies where state policies can distort auctions. Pet. App. 10a-11a. Initially, FERC determined that the rule was designed solely to prevent large electricity buyers from manipulating auctions. *PJM Interconnection, L.L.C.*, 137 FERC ¶61,145, at ¶205 (2011). As a result, it initially exempted certain state-supported generators. *PJM Interconnection, L.L.C.*, 117 FERC at 62,671 n.75. But FERC later revised the rule to require state-supported generators to bid above a certain price floor. *PJM Interconnection*, 135 FERC at 61,106. FERC determined that the amendment was necessary to ensure that "wholesale capacity market prices remain at just and reasonable levels." *Ibid.*; see *N.J. Bd. of Pub. Utils.* v. *FERC*, 744 F.3d 74, 86, 91, 98-101 (3d Cir. 2014).

1. This case reflects precisely the sort of concerns the FPA directs to FERC in the first instance. Accord-

ing to the court of appeals, respondents are aggrieved by *the contract* between CPV and the Maryland utilities mandated by the MPSC. Pet. App. 17a-19a. (Indeed, the court specifically refused to address whether direct subsidies, not in the form of a contract for differences, would be problematic. *Id.* at 21a.) And respondents complained about the same thing. They asserted that the "Contracts"—by requiring the utilities to pay CPV a certain rate even if auction rates drop below that threshold—will depress CPV's bids and "suppress market clearing prices" as a result. Dist. Ct. Compl. ¶ 70; see *id.* ¶¶ 67, 73, 77-78; Pet. App. 22a-23a (expressing concern that "the CfDs," because of their duration, might "seriously distort the PJM auction's price signals"). It is thus the contracts and their interaction with federally regulated markets—not a state commission order itself—that aggrieves respondents.[7]

Because the contracts here are wholesale agreements within FERC's jurisdiction, the FPA required respondents to seek review at FERC, not in federal court. Congress gave FERC authority to act on unreasonable rates or practices, including in response to a complaint filed by an aggrieved party. 16 U.S.C. §§ 824d(e), 824e(a), 825e. If a party is dissatisfied with FERC's decision, it may seek rehearing and ultimately judicial review. *Id.* § 825*l*.[8] The statute thus gives "exclusive

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[7] Respondents could not claim injury if, for example, the MPSC had issued the Generation Order but nobody had responded with bids, or had all bids been rejected. Respondents are affected, not because the MPSC seeks to regulate wholesale rates, but because of the effect the contracts have on federal markets.

[8] Alternatively, if FERC promulgates a regulation that affects rates, a party may seek review under the Administrative Procedure Act. See 5 U.S.C. §§ 702-704, 706.

authority over rate regulation to the Commission." *Ark. La. Gas Co.* v. *Hall*, 453 U.S. 571, 580 (1981). Consequently, "[t]he reasonableness of rates *and agreements regulated by FERC* may not be collaterally attacked in state *or federal courts*." *Miss. Power & Light Co.* v. *Miss. ex rel. Moore*, 487 U.S. 354, 375 (1988) (emphasis added). "The *only* appropriate forum for such a challenge is before the Commission or a court reviewing the Commission's order." *Ibid.* (emphasis added). By challenging the agreements in federal court instead, respondents bypassed the mandatory remedies Congress established.[9]

2. Respondents, moreover, do not merely challenge the contracts as inconsistent with federal law. They also seek to collaterally attack the efficacy of PJM's minimum-offer-price rule. Respondents' suit—and the government's position here—rests entirely on the premise that the rule is not adequate to prevent these contracts from distorting federal auctions. Dist. Ct. Compl. ¶74; Gov't Br. Pet. Stage at 15, 18. But a proper minimum-offer-price rule would protect PJM's auctions by excluding or "mitigating" all below-cost bids. See pp. 9 & n.4, 19, *supra*. Indeed, FERC specifically amended the minimum-offer-price rule for the purpose of addressing uneconomic entry and bidding by state-supported entities. See p. 19, *supra*.

The premise that PJM's minimum-offer-price rule is ineffective underscores why this action belongs before FERC.[10] If FERC is failing to ensure that PJM's auction

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[9] Some may argue that the CPV-utility contracts are not within FERC's jurisdiction to address. But if that is so, it is hard to see how federal law could preempt them. See p. 33, *infra*.

[10] NRG too has serious doubts that PJM's minimum-offer-price rule is adequate to ensure just-and-reasonable rates. See Request for

rules produce just-and-reasonable rates—*i.e.*, if the minimum-offer-price rule is failing to screen out uneconomic bids—FERC should change the rule. Parties should demand that change and seek judicial review if it is not forthcoming. See, *e.g.*, *ISO New England, Inc.*, 151 FERC ¶61,226 (2015) (challenging auction results); *PJM Interconnection, L.L.C.*, 135 FERC ¶61,022 (2011) (challenging auction rules). Indeed, that would be the *only* available course of action if the claimed distortions here resulted from purely private contracts for differences or other private agreements. As explained below, respondents' failure to follow that course here—and to seek a federal-court declaration of preemption instead—leads to problematic results.

B. Judicial Intervention Produces Ill-Tailored Remedies and Undermines Incentives

Despite FERC's powers, respondents sought a preemption ruling from a federal court. Obliging that request, the court of appeals held that preemption was appropriate to protect the "rates established through a FERC-approved market mechanism." Pet. App. 19a. Such a judicial (rather than regulatory) remedy, however, is both under- and over-inclusive. It leaves defective federal regulations on the books, while cutting deeply and unnecessarily into traditional areas of state authority. And it encourages parties and FERC itself to use case-by-case judicial preemption—rather than calibrated action by the expert agency—as the means of fulfilling the FPA's mandates.

1. The core of FERC's mission is the obligation to ensure that wholesale rates remain "just and reason-

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Rehearing of the NRG Companies in *PJM Interconnection, L.L.C.*, Nos. ER13-535-000, ER13-535-001 (FERC).

able." 16 U.S.C. §824d(a); see also *id.* §824e(a). FERC—not the Judiciary—bears that responsibility. This Court thus requires utilities wishing to challenge a tariff to seek an initial hearing from FERC. See *Miss. Power & Light*, 487 U.S. at 375; *Montana-Dakota Util. Co.* v. *Nw. Pub. Serv. Co.*, 341 U.S. 246, 251-252 (1951). Federal courts are limited to reviewing FERC's determination. *Miss. Power & Light*, 487 U.S. at 375; *Montana-Dakota Util.*, 341 U.S. at 251-252. Although parties may ultimately obtain judicial review, that process allows FERC to apply its "expert and specialized knowledge" to ratemaking, *United States* v. *W. Pac. R.R. Co.*, 352 U.S. 59, 64 (1956)—a task that "administrative agencies" often handle "far better * * * than judges," *Armstrong* v. *Exceptional Child Ctr., Inc.*, 135 S. Ct. 1378, 1388 (2015) (Breyer, J., concurring).

The minimum-offer-price rule illustrates how regulatory expertise can calibrate federal-market protections while limiting intrusion into state authority. The rule is not a blunderbuss remedy—it neither forbids state support for generation nor bans state-supported generators from bidding in federal auctions. It does not purport to preclude any exercise of state authority. Instead, the rule addresses conduct in PJM wholesale capacity auctions, an area that is FERC's to regulate. In particular, it uses a price floor to "promote economically efficient markets" (*i.e.*, markets that produce reasonable rates) but otherwise allows "[S]tates to pursue * * * legitimate state policy objectives." *New England States Comm. on Elec.* v. *ISO New England Inc.*, 142 FERC ¶61,108, at 61,488 (2013). If a bid is below-cost, it is mitigated to eliminate any adverse effect. The rule is the type of nuanced remedy one expects under a federal scheme "conceived entirely as a supplement to * * * State

regulation." *Conn. Light & Power Co.* v. *Fed. Power Comm'n*, 324 U.S. 515, 525 (1945). FERC operates in its domain, ensuring reasonable wholesale rates through rules governing wholesale auctions. States operate in theirs, promoting their choice of generation resources for the benefit of their residents.

If the minimum-offer-price rule works as intended, it should keep auction rates reasonable—fulfilling FERC's statutory obligation—whether or not state-supported generators bid. See *ISO New England, Inc.* v. *New England Power Pool Participants Comm.*, 135 FERC ¶61,029, at ¶¶157, 170-171 (2011); *PJM Interconnection*, 135 FERC at 61,106. Federal courts need not prohibit an array of state-sponsored contracts to solve a problem that FERC has already addressed. Conversely, if FERC's auction rules are flawed, FERC should revise them; parties should petition for those revisions; and aggrieved parties should seek judicial review if FERC fails to do so. See 16 U.S.C. §824d(a) ("[A]ll rules and regulations affecting or pertaining to * * * rates or charges *shall* be just and reasonable." (emphasis added)). Either way, the initial solution to state actions that produce distorted—*i.e.*, unjust or unreasonable—prices lies with FERC.

2. Bypassing FERC in favor of a judicial declaration of preemption produces remedies that are simultaneously under- and over-inclusive. A declaration is under-inclusive because it leaves in place an inadequate federal minimum-offer-price rule. It thus leaves wholesale auctions vulnerable to the distorting effect of below-cost bids from any other source. At the same time, a preemption decree is over-broad, reaching into an area of traditional authority that FERC sought to preserve. When it developed minimum-offer-price rules and allowed for

their application to state-sponsored generation, FERC did *not* attempt to prohibit the underlying state regulatory actions or contracts. Instead, it decided to remedy any effect on federal auctions by establishing rules for the auctions' operation.

That choice was deliberate. Like other agencies, FERC acts on policy considerations. See *Chevron, U.S.A., Inc.* v. *Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 865 (1984). They inform what rates FERC allows, see, *e.g.*, *Fed. Power Comm'n* v. *Hope Nat. Gas Co.*, 320 U.S. 591, 614 (1944), and as here, what rules FERC approves for federal auctions. FERC designs rules to ensure that prices will spark sufficient investment in capacity—which is one component of what FERC deems a reasonable rate. See *PJM Interconnection*, 117 FERC at 62,652. FERC also tries to "accommodat[e] the ability of [S]tates to pursue * * * legitimate state policy objectives." *New England States Comm. on Elec.*, 142 FERC at ¶61,488; see also *Midwest Indep. Transmission Sys. Operator, Inc.*, 153 FERC ¶61,229 at ¶46 (2015). Here, FERC adopted a surgical solution for price distortions caused by state-supported generation: the minimum-offer-price rule. FERC acted on prices in federal auctions and those prices alone—without specifically prohibiting state policies or certain contracts. By contrast, the preemption ruling below sweeps broadly, invalidating state regulatory initiatives.

Allowing federal courts rather than FERC to take the lead in addressing this issue, moreover, undermines FERC's incentive to undertake the often sensitive task of regulating with due respect for state interests. When acting in agency proceedings, FERC itself opted to accommodate state contracts that support generation. FERC did not proscribe such contracts, but instead

regulated their potential effect on federal markets. Before this Court, however, FERC's lawyers now support a decree that goes further. But that improperly relieves FERC of its obligation to ensure just-and-reasonable pricing in federal markets. And, by placing the matter before courts rather than regulators, it forecloses the sort of tailored approach that can accommodate multiple interests. If FERC must go beyond pricing rules to ensure wholesale rates remain just and reasonable—instead proscribing a category of state-sponsored contracts—the Commission itself rather than its lawyers should be responsible for announcing that undertaking.

3. Those impacts could all be easily avoided. Federal law provides a path to challenge the CPV-utility contracts, and the minimum-offer-price rule if it does not sufficiently protect PJM auction rates. See pp. 10, 20, *supra*. Respondents could challenge the reasonableness of any agreement and the adequacy of PJM's rules. The courts below should not have allowed respondents to pursue this action instead. Because respondents challenge the reasonableness of energy contracts, they were *obligated* to pursue the complaint process before FERC. See pp. 20-22, *supra*. And claims that the CPV-utility contracts undermine federal ratemaking should have been raised before FERC as well.

Respondents seek declaratory and injunctive relief, which is inherently discretionary and equitable. See *Eccles* v. *Peoples Bank of Lakewood Vill.*, 333 U.S. 426, 431 (1948). Courts ought not contemplate such relief where a federal agency, with expertise, may be able to craft a regulatory solution that better harmonizes the relevant interests—and where judicial relief may discourage regulatory solutions. Even in damages cases,

courts often refer disputes to federal agencies in view of their "special competence." *W. Pac. R.R. Co.*, 352 U.S. at 63-64 (primary jurisdiction). Here, moreover, respondents are injured not by a state order but by the effect of contracts on FERC-supervised markets. For that reason, too, the courts should have demurred in favor of FERC-initiated resolutions.

This Court has sometimes held state actions preempted in cases where the litigants did not proceed before FERC. See, *e.g.*, *Miss. Power & Light*, 487 U.S. 354; *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293 (1988); *Pub. Util. Comm'n* v. *United Fuel Gas Co.*, 317 U.S. 456 (1943). That course might be appropriate where there is no mechanism for challenges before FERC and no potential claim that FERC might accommodate state policies through calibrated regulation. But where Congress has authorized FERC to address the contracts that allegedly affect federal markets, and FERC has in place means for addressing the impact of such contracts, the remedy in the first instance should be an action before FERC—not a federal lawsuit seeking to preempt state policies.

II. THE GENERATION ORDER IS NOT PREEMPTED

When Congress passed the Federal Power Act in 1935, no one would have thought the States had lost their authority to provide incentives for the development of generation facilities. Congress passed the Act with a limited purpose: to "fill the gap" left by *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927). See *United States* v. *Pub. Util. Comm'n*, 345 U.S. 295, 308 (1953). In *Attleboro*, the Court had held that States lacked authority to regulate energy sold at wholesale or transmitted in interstate commerce. 345 U.S. at 89-90. The FPA was enacted to allow federal

regulation of wholesale energy markets as a "supplement," not a "substitut[e] for," state regulation. *Conn. Light & Power*, 324 U.S. at 525-526.

States thus continue to exercise extensive regulatory and contracting authority. That their actions can impact federal markets, or provide incentives beyond those provided by federal law, is an insufficient basis for preemption. The sheer range of what States can do means that their actions "inevitabl[y]" affect wholesale markets. *Nw. Cent. Pipeline Corp.* v. *State Corp. Comm'n*, 489 U.S. 493, 515 (1989).

A. The Generation Order Regulates Within a Field of Traditional State Concern

1. "[C]haracteristically," States determine whether there is a "[n]eed for new power facilities." *Pac. Gas & Elec.*, 461 U.S. at 205. In States with vertically integrated utilities, the State (together with the regulated utility) determine plant size and siting. See *id.* at 205-206, 213-216. Even in regions with restructured markets, the States still control permitting, siting, and compliance with land-use restrictions. NRG operates many power plants—including its Marsh Landing Generating Station and El Segundo Energy Center, as well as many renewable resources—under state-approved contracts. Those contracts allow firms to arrange more attractive financing by mitigating market risk, and also aid States in meeting their public policy goals. Ezra Hausman, *et al.*, *Bilateral Contracting in Deregulated Electricity Markets: A Report to the American Public Power Association* 15-16 (Apr. 18, 2008).

Concomitantly, many States regulate the type of generation resources that are developed. Numerous States have long required utilities to own a certain portfolio of conventional generation resources, such as

coal, nuclear, or gas power plants. See *New York* v. *FERC*, 535 U.S. 1, 24 (2002). More recently, some States have sought to encourage the use of renewable energy. *Entergy Nuclear Vt. Yankee, LLC* v. *Shumlin*, 733 F.3d 393, 417 (2d Cir. 2013). And still others seek to drive technological innovation in the energy sector by directing contracts in battery storage, fuel cells, and other cutting-edge energy investments. Often, that is achieved through a variety of incentives—or directly through long-term contracts.

For example, since the 1970s, many States have granted tax incentives for investments in renewable energy. Jeremiah I. Williamson & Matthias L. Sayer, *Federalism in Renewable Energy Policy*, 27 Nat. Res. & Env't 19, 19-20 (2012). More than 20 States offer tax credits for investment in solar power. See N.C. Clean Energy Technology Center, *Solar Policy Guide: A Resource for State Policy Makers* 18 (Sept. 2012). A third of all States and the District of Columbia now operate taxpayer-funded trusts that invest directly in renewable energy projects. Steven Ferrey, *Alternative Energy in a Spaghetti Western: Clint Eastwood Confronts State Renewable Energy Policy*, 32 Utah Envtl. L. Rev. 279, 293 (2012). Most States and the District of Columbia have renewable portfolio standards, which require utilities to obtain a portion of their energy from renewable sources. N.C. Clean Energy Technology Center, *Programs*, DSIRE (2015), http://goo.gl/tJHJCP. And nearly every State has a net-metering program that allows customers producing renewable energy to receive a kilowatt-for-kilowatt credit on their utility bills for the excess energy delivered to the utility. *Ibid.*; Ferrey, *supra*, at 297.

By increasing supply in the short-term, and affecting development incentives in the long-run, such state-driven programs inevitably impact wholesale markets.[11] Yet States have traditionally regulated "these aspects of electrical generation * * * in great detail." *Pac. Gas & Elec.*, 461 U.S. at 206; see also *New York*, 535 U.S. at 24.

2. Consistent with that, the court of appeals observed that "not 'every state statute that has some indirect effect' on wholesale rates is preempted." Pet. App. 21a (quoting *Schneidewind*, 485 U.S. at 308). Accordingly, the court focused on the contracts for differences, holding that such contracts intrude on FERC's authority to "set" wholesale rates. The court recognized that such contracts did not "formally" set wholesale rates, Pet. App. 19a, and properly so. Neither the contracts nor the Generation Order purport to set federal-auction prices. They transfer risk—protecting CPV from the impact of low wholesale capacity prices, while helping shield the Maryland utilities from the impact of higher prices.

The court of appeals characterized the contracts for differences as "functionally" setting wholesale rates. Pet. App. 17a-19a. But contracts for differences do no such thing. Consider, for example, a capacity supplier that hedges using such a contract. The supplier might sell off the right to receive any increased revenues if auction prices exceed a certain price, and buy insurance that will pay it additional sums if auction prices fall below that price. No one would say the capacity supplier has "set"

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[11] California, the State with the most renewable-energy mandates, predicts that its solar generation will drive energy prices negative during the day, forcing generators to pay utilities to take energy. Chadbourne, *Renewables Face Daytime Curtailment in California* (Nov. 2014), http://goo.gl/S2etpG.

the wholesale rate. It has simply shifted the benefits and burdens of market changes to contractual counterparties. A contract-for-differences is no different. Nor does it matter that these contracts are the product of state regulation. FERC has not found it necessary to proscribe the use of contracts for differences by private parties to meet private needs. See pp. 33, 35, *infra*. *A fortiori* there is no basis for precluding their use to support important state policies.[12]

The contracts required by the Generation Order undoubtedly affect capacity auctions. That is why the application of an effective minimum-offer-price rule should be employed. For the same reason, however, preemption is inappropriate. *Every* state decision to authorize a power plant, to mandate the purchase of renewable energy, or to raise retail rates also affects supply and demand and, as a result, wholesale prices as well. In making those decisions, States often have the same goal that Maryland did here: to spur new generation. Federal law simply does not itself displace state actions "target[ing]" the development of generation even when those actions "affect[ ]" wholesale prices. *Oneok, Inc.* v. *Learjet, Inc.*, 135 S. Ct. 1591, 1599 (2015) (emphasis omitted).

Precisely because States so often pursue policies that promote the development of generation, the court of appeals exempted from its holding "direct subsidies" and "tax rebates," which it said "may or may not differ in

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[12] That conclusion is reinforced by the presumption that Congress did not preempt "the historic police powers of the States" absent "clear and manifest" indications to the contrary. *Medtronic, Inc.* v. *Lohr*, 518 U.S. 470, 485 (1996). Regulation of electric utilities is within the States' traditional police powers. See *Pac. Gas & Elec.*, 461 U.S. at 205-206.

important ways from the Maryland initiative." Pet. App. 21a. But the necessity of that exemption underscores the flaw in the court's holding. Traditional state measures to promote generation are permissible. They do not become impermissible simply because the State employs contracts for differences instead of some other mechanism. If a particular contract within FERC's jurisdiction amounts to an unreasonable practice (state-sponsored or not), *FERC* may of course review it under traditional standards. And *FERC* has ample authority to approve market rules that prevent uneconomic bidding in federal markets regardless of cause. But Congress afforded that authority to *FERC*. Federal courts should not substitute their authority by invalidating state policies under the rubric of preemption.

3. Longstanding federal policy buttresses that conclusion. The minimum-offer-price rule gives FERC control over wholesale auction rates without impinging on States' abilities to support new generation. See *New England States Comm. on Elec.*, 142 FERC at ¶61,488. That specific accommodation for state-supported generation demonstrates that federal law does not preempt state actions that—like the Generation Order—may affect wholesale prices. See *Ark. Elec. Coop. Corp.* v. *Ark. Pub. Serv. Comm'n*, 461 U.S. 375, 387-388 (1983). Instead, FERC's decision to act on price alone spotlights the line between preempted and permissible state actions: States may regulate in ways that affect wholesale prices; they simply cannot purport to regulate federal markets. FERC, in turn, regulates bidding behavior in federal markets to ensure federal rates remain just-and-reasonable nonetheless. FERC's longstanding approach is therefore "wholly inconsistent with

pre-emption of state regulatory jurisdiction." *Ark. Elec. Coop.*, 461 U.S. at 387-388.

Indeed, FERC has steered clear of regulating contracts, like swap agreements, that allow generators to hedge against fluctuating prices. There is a multi-billion market for such swaps. Many of those contracts promise generators a fixed price, transferring the risks (and benefits) of wholesale price changes to others. Yet FERC has never suggested that such contracts undermine federal markets, much less improperly "set" wholesale rates. It is hard to see why contracts for differences, which likewise protect generators from price risk, should be categorically different.

B. State-Sponsored Contracts Do Not Conflict With Federal Policy

The court below also relied on conflict-preemption principles. But those principles "must be applied sensitively" to preserve the role that the Federal Power Act expressly reserves for the States. *Nw. Cent. Pipeline*, 489 U.S. at 515. Here, that required sensitivity of application was lacking.

To secure just-and-reasonable wholesale energy pricing, FERC has imposed market rules designed to ensure that various forces—including market manipulations and state-sponsored contracts—do not artificially depress prices in federal capacity auctions. See *PJM Interconnection*, 137 FERC at ¶¶2, 96. But FERC did not ban state-sponsored contracts. Instead, recognizing the role of state authority in energy markets, FERC accommodated the States' "legitimate * * * policy objectives." *New England States Comm. on Elec.*, 142 FERC at ¶61,488. It did so by directly addressing only the conduct of—and effects within—federal markets. See pp. 23-25, *supra*.

The Generation Order does not conflict with that policy. It is not "impossible" for a generator to comply with both the Generation Order and participate in FERC's auction process. *Nw. Cent. Pipeline*, 489 U.S. at 516. Rather, the Generation Order contemplates that parties to the contracts it authorized would participate in federal auctions. FERC is capable of crafting a policy that ensures just-and-reasonable rates. State-sponsored bidders may participate in federal auctions, but only subject to a minimum-offer-price rule designed to mitigate the ill-effects of below-cost bids. It defies common sense to say that federal policy is thwarted by what it specifically accommodates.[13]

The court below, however, held that the Generation Order conflicts with federal policy because the resulting contract provides different incentives than those provided by federal auctions. Pet. App. 22a-23a. To the extent the court was concerned that the order might affect how much new capacity is actually built, the court overreached. Since the electric energy industry's advent, States have "granted or withheld" permission to build power plants "at the[ir] pleasure." *Pac. Gas & Elec.*, 461 U.S. at 205 (quoting *Frost* v. *Corp. Comm'n*, 278 U.S. 515, 534 (1929) (Brandeis, J., dissenting)). States can order utilities to build more power plants. See *id.* at 205-206. It cannot be that preemption arises where States follow a lesser course, using incentives rather than command-and-control mandates.

Besides, the FPA expressly reserved to the States the power to set retail rates. See 16 U.S.C. §824(b)(1).

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[13] An effective minimum-offer-price rule might also *deter* contracts that *seek* to depress auction prices below just-and-reasonable levels. But that too ensures the integrity of federal markets and fulfills FERC's obligation to ensure just-and-reasonable rates.

Those rates too send price signals that affect generation development and wholesale markets. See Electric Energy Market Competition Task Force, *Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy* 45-46 (Apr. 5, 2007). But States did not lose their traditional power to send price signals through contracts rather than retail rates.

The court of appeals' analysis also ignores the critical role of bilateral contracts. In 2006, 92.8% of energy sales in PJM's spot markets reflected, or were conducted to meet obligations under, bilateral contracts. Hausman, *supra*, at 14. Those contract rates are set outside the federal-auction process—and are often fixed for lengthy periods. American Public Power Association, *supra*, at 1; Teichler & Levitine, *supra*, at 690-691. Bilateral contracts thus exhibit the very features (length and fixed rates) that led the Fourth Circuit to invalidate CPV's contracts. Under the *Mobile-Sierra* doctrine, however, federal law generally precludes FERC from revising bilateral contracts absent compelling public need. See *Morgan Stanley Capital Grp. Inc.* v. *Pub. Util. Dist. No. 1*, 554 U.S. 527, 550 (2008). The fact that federal law allows for a market with price signals set independently of FERC's auctions—by private negotiation—belies the court of appeals' one-price-to-rule-them-all philosophy.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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