No. 18-868

IN THE

Supreme Court of the United States

ELECTRIC POWER SUPPLY ASSOCIATION, NRG ENERGY, INC., AND CALPINE CORP.,

Petitioners,

v.

ANTHONY STAR, in his official capacity as Director of the Illinois Power Agency, and BRIEN J. SHEAHAN, JOHN R. ROSALES, SADZI MARTHA OLIVA, D. ETHAN KIMBREL, and ANASTASIA PALIVOS, in their official capacities as Commissioners of the Illinois Commerce Commission, and EXELON GENERATION COMPANY, LLC,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

Reply Brief for Petitioners

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REPLY BRIEF OF PETITIONERS

The Question Presented in this case is how the reasoning of *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288 (2016), applies to a state subsidy program that is designed to deliver exactly what the program preempted in *Hughes* delivered—a state-determined, above-market payment for each megawatt-hour of electricity that favored producers who sell at wholesale—without a formal bid-and-clear requirement. Had Illinois enacted the ZEC subsidy program in its current form and merely added an explicit requirement that subsidy recipients bid their output into wholesale auctions, it would be preempted under *Hughes*. Respondents nevertheless claim that *Hughes* requires preemption *only* when a formal "bid-and-clear" requirement is present—that *Hughes* should be "limited" to its facts. E.g., Brief in Opposition of Respondent Exelon Corporation ("Ex. Opp.") at 2; Brief in Opposition of Illinois State Respondents ("Ill. Opp.") at 2–3. But the "bid-and-clear" requirement made *Hughes* an easy case. This Court left for another day the question of how to mark the boundary of exclusive federal authority over the payments producers receive in connection with wholesale sales. 136 S. Ct. at 1293.

Due to States' efforts to skirt *Hughes*, that day has arrived. In *Coalition for Competitive Electricity v. Zibelman*, 906 F.3d 41 (2d Cir. 2018) (*Zibelman*), a similar case that is also the subject of a pending petition for certiorari (Docket No. 18-879), the Second Circuit conceded that such a program came "as near as can be without crossing" the line that demarks exclusive federal authority over wholesale rates. *Id.* at 54. But the Second Circuit, along with the Seventh

Circuit in this case, reached that conclusion only because it read *Hughes* as drawing that line at a bid-and-clear requirement. Thus, the courts of appeals dismissed as irrelevant the practical reality central to a proper preemption analysis: Petitioners' well-pleaded allegation that Illinois's ZEC program did not need a formal-bid and-clear requirement to function as a direct wholesale subsidy because the favored nuclear producers necessarily sell all of their output at wholesale—*i.e.*, they always "clear" in wholesale markets 100% of the electricity they produce. Given how easy it is for States to design around a formal bid-and-clear requirement, limiting *Hughes* to that unique circumstance effectively renders it a dead letter.

Although Respondents pretend otherwise, the decision below and the comparable ruling in *Zibelman* have caused considerable concern. This Court has the benefit of numerous *amicus* briefs from industry participants and expert economists who believe these rulings seriously compromise the longstanding federal policy favoring market-based wholesale rates. The neutral and independent market monitor for the PJM market ("Market Monitor")—the world's largest wholesale energy market, covering 13 states and the District of Columbia—agrees. See Amicus Brief of Monitoring Analytics, LLC ("Monitor Br."), at 4, (Feb. 7, 2019) ("If anything, Petitioners understate the risk. The public will be ill served if regulation through competition survives in name only.").

The Federal Energy Regulatory Commission (FERC) has acknowledged that ZEC programs distort wholesale markets, and is struggling to find a way to limit the damage. See *Calpine Corp. v. PJM Inter-*

connection, LLC, 163 FERC ¶ 61,236 at 68–69 (out-of-market support for certain generators, such as ZEC programs, "have reached a level sufficient to significantly impact the capacity market clearing prices and the integrity of the resulting price signals on which investors and consumers rely," such that FERC can no longer "harness competitive market forces [to] produce just and reasonable rates"). While FERC has inexplicably concluded that *Hughes* requires it to tolerate these distortions, *Hughes* holds the opposite: States "cannot regulate in a domain Congress assigned to FERC and then require FERC to accommodate [that] intrusion." 136 S. Ct. at 1298 n.11

Only this Court can provide the definitive guidance that FERC, the States, and industry participants urgently need. Emboldened by the decisions now before this Court, States are moving aggressively to increase the wholesale revenues of favored producers above the level FERC has deemed just and reasonable. And FERC's apparent acquiescence suggests a fundamental shift away from the longstanding federal policy of requiring that wholesale rates be set through competition, without anything approaching the formal process or reasoned decision-making that should accompany such a dramatic change. As the Market Monitor put it: "If *Hughes'* proper and reasonable demarcation of federal and state jurisdiction over the nation's interconnected wholesale power market is not confirmed, it will mean the end of a major federal regulatory initiative." Monitor Br. 4. Review of this issue is manifestly warranted.

I. That Two Circuits and FERC Have Misread *Hughes* Counsels in Favor of, Not Against, Granting the Petition

Like the respondents in *Hughes*, Brief in Opposition at 15-31, Nos. 14-614, 14-623 (Feb. 11, 2015), Respondents argue that review is not warranted because there is no circuit split. See Ex. Opp. at 15–21; Ill. Opp. at 21–22. Petitioners did not seek review on that basis, but rather because, as the Court recognized in *Hughes*, whether States can subsidize wholesale electricity sales in the manner of Illinois's ZEC program is a question of considerable importance to the energy industry and the Nation's economy. The court of appeals upheld the ZEC program based on an incorrect reading of *Hughes*. Only this Court can clarify the scope of its ruling. Review of the issue is plainly warranted. See Sup. Ct. Rule 10(c).

If Respondents want to count noses, see Ex. Opp. 1, 15 ("all eight judges to have considered the question agree"), they cannot overlook that this Court unanimously held in *Hughes* that States cannot supplant FERC-authorized "rates and charges … received … for or in connection with interstate wholesale sales" by guaranteeing favored producers will receive an alternative, state-determined level of compensation over and above those amounts. 136 S. Ct. at 1298–99 (citing § 824d(a)). As explained in the Petition and confirmed by *amici*, that is precisely what the challenged subsidy does: ZECs guarantee that uneconomic nuclear generators receive a minimum, state-determined level of compensation in connection with wholesale sales, regardless of FERC-approved market-based rates. See Pet. 16–23; Amicus Brief of

Energy Economists ("Econ. Br."), at 10–13 (Feb. 7, 2019).

If anything, that two courts of appeals have confined *Hughes* to its facts counsels in favor of review. See *Thurston Motor Lines, Inc. v. Jordan K. Rand, Ltd.*, 460 U.S. 533, 535 (1983) (lower courts should not "confuse[] the factual contours of [this Court's decision] for its unmistakable holding"). The lower courts' reading gives States a roadmap to circumventing *Hughes*: "Legislators can easily contravene FERC's authority over wholesale rates by artful description or avoiding description of the [subsidy] mechanism…. An explicit tether like that appearing in *Hughes* is easily avoidable." Monitor Br. 4.

Nor should the Court deny review in deference to a cursory *amicus* filing by FERC and the United States in this case. See Ill. Opp. 22; Ex. Opp. 1–3, 20–21. That brief reflects a sharp and unexplained departure from the well-established federal policy that market-based methods should determine just and reasonable wholesale electricity rates.[1] In any event, this Court must independently determine whether the State has overrun the jurisdictional boundary Congress established in the FPA. Pet. 28–30 (citing *New York v.*

[1] Respondents suggest that the views FERC expressed as an *amici* below are entitled to *Chevron* deference. Ill. Opp. 30, 32; Ex. Opp. 4, 35 & n.9. Even if FERC's jurisdiction-defining statutory provisions were sufficiently ambiguous to justify *Chevron* deference, but see *FERC v. Electric Power Supply Ass'n*, 136 S. Ct. 760, 773 n.5 (2016), it is doubtful the agency's litigation position is entitled to deference given its views in *Hughes*, see Pet. 32, and its longstanding approach to market-based wholesale rate-setting, see Amicus Brief of Am. Petroleum Inst. and Nat. Gas Supply Ass'n ("API-NGSA Br.") at 7–17, No. 18-879 (Feb. 8, 2019).

FERC, 535 U.S. 1, 41–42 (2002) (Thomas, J., dissenting)). This Court has rejected FERC's preemption position before, see *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 222–23 (1983), and should do so again.

II. The Threat the ZEC Program Poses to the Proper Allocation of Authority Under the FPA Warrants This Court's Intervention

The gravamen of the Petition is that the ZEC program effects a fundamental shift in FPA's division of federal and state authority and threatens the integrity of a major federal energy policy. Numerous *amici* agree. Monitor Br. 3–5; Econ Br. 14–19; API-NGSA Br. 5–17; Amicus Brief of Industrial Customers, at 5–13 (Feb. 7, 2019). Respondents' attempts to explain away these pressing policy concerns are unpersuasive.

1. Respondents argue that the Court's review is unwarranted because "there is no stampede of state laws to subsidize nuclear power generation due to its environmental benefits." Ill. Opp. 22–23. Respondents miss the point. Even if no other States followed suit, the market distortions caused by the Illinois and New York ZEC programs would be cause for grave concern; that another State (New Jersey) has implemented its ZEC subsidy, and others are considering similar programs, only proves the detrimental impact of the decision below will worsen. See Econ. Br. 14–19 & n.7.

2. Similarly inapt is the suggestion that other state renewable energy programs, such as renewable energy credits ("RECs"), produce similar market

effects. See Ill. Opp. 34; Ex. Opp. 23–24. The preemption inquiry does not turn on the downstream impacts of these programs; what matters is whether such programs impermissibly second-guess or disregard FERC-authorized rates.[2] The two programs are materially different in that way. Although ZECs are available only to failing nuclear plants, RECs are available to all qualified renewable generators, regardless of economic need. And ZEC prices are set at state-determined rates that move in tandem with wholesale prices, whereas RECs are traded on the free market. See Pet. 10 n.2; Monitor Br. 5–6. ZECs target perceived insufficient wholesale rates (forbidden under *Hughes*), while RECs do not.

3. Respondents also argue that FERC is best suited to remedy the market distortions that ZECs cause. Ill. Opp. 22–23; Ex. Opp. 20–23. This argument is misguided for three reasons.

First, its premise is that if FERC can mitigate ZECs' harmful impact on federal energy policy, ZECs are not preempted. That is exactly backwards. See *Hughes*, 136 S. Ct. at 1298 n.11; *Nw. Central Pipeline Corp. v. State Corp. Comm'n of Kan.*, 489 U.S. 493, 518 (1989) ("The NGA does not require FERC to regulate around a state rule.").

Second, as the Market Monitor comprehensively explains, FERC's ability to ameliorate the market impacts of ZECs is doubtful. Monitor Br. 8–15. After years of consideration, FERC is not close to acting to reduce the damage to wholesale markets that these

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[2] *WSPP Inc.*, 139 FERC ¶ 61,061 (2012), predates *Hughes* and thus did not consider this question.

programs produce—in the meantime, wholesale rates are distorted by multi-billion-dollar subsidies flowing to favored producers.

Third, FERC has already determined that ZECs are causing serious wholesale market distortions. See *Calpine*, 163 FERC ¶ 61,236, at 63–69. Those real-world impacts strongly suggest that the lower courts have drawn the jurisdictional boundary incorrectly, a question not likely to be ventilated further in FERC's regulatory efforts. By the same token, Petitioners cannot vindicate the jurisdictional claim they press here by seeking judicial review of any remedial order FERC might adopt in the future.

III. The Decisions Below Cannot Be Reconciled with *Hughes* or This Court's Preemption Precedents

Respondents advance the same merits arguments that persuaded the lower court to go awry. The Petition details why these arguments are inconsistent with *Hughes* and this Court's approach to preemption, but Petitioners highlight a few flaws again here.

1. The Illinois Respondents argue that the ZEC program does not infringe FERC's authority because it "is not wholesale ratemaking in form or function." Ill. Opp. 24–25. This is a straw man. Petitioners are not arguing that ZECs are "consideration for the sale of electricity," *id.* 24, or that ZECs impermissibly *affect* wholesale prices, *id.* 26–27. In both design and operation, ZEC subsidies impermissibly supplant FERC-authorized rates by guaranteeing favored producers will receive state-determined levels of income for making wholesale sales. See Pet. 18–23. Put dif-

ferently, the constitutional infirmity of ZECs stems not from the indirect *ex post* market effects of promoting energy production, but from Illinois's *ex ante* "second-guess[ing] the reasonableness of interstate wholesale rates" and "disregarding" those rates in favor of wholesale compensation levels the State prefers. *Hughes*, 136 S. Ct. at 1298–99. Respondents ignore that core holding of *Hughes*.

2. Respondents argue that the ZEC program is permissible because it regulates power *generation*, citing *Northwest Central Pipeline*. Ill. Opp. 26–28; Ex. Opp. 35–36. But *Hughes* prohibits second-guessing or disregarding FERC-approved wholesale rates, *even when* the State is acting in an area traditionally reserved for state regulation. 136 S. Ct. at 1299. Indeed, before *Hughes*, the Court twice rejected State attempts to disregard federally approved wholesale rates where the challenged measures regulated a quintessential sphere of state authority: retail rates. See *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986). States have broad authority to regulate in-state generation, but cannot use that authority to "disregard[] an interstate wholesale rate required by FERC." *Hughes*, 136 S. Ct. at 1299.

3. Respondents invoke the purpose of the ZEC program and attempt to distinguish the Maryland subsidy this Court held preempted in *Hughes* on that basis. See, e.g., Ex. Opp. 32–33. *Hughes* prohibits this type of purposive inquiry. 136 S. Ct. at 1298 (States "may not seek to achieve ends, however legitimate, through regulatory means that intrude on FERC's authority over interstate wholesale rates").

But even on its own terms, Respondents' attempt to distinguish the Maryland program fails. Exelon claims that, unlike that program, "the ZEC Program does not, and does not need to, hijack FERC's wholesale markets to accomplish" "the State's environmental objectives." Ex. Opp. 33. But the entire purpose of the ZEC subsidy is to ensure that nuclear generators that would otherwise be forced to retire stay in the wholesale marketplace even though they could not operate profitably at FERC-approved wholesale rates, purportedly to advance Illinois's environmental goals. See Pet. 9–10. Thus, just as in *Hughes*, the State is disrupting the ordinary operation of the wholesale markets to accomplish its aims.

4. Exelon argues that Petitioners' reading of *Hughes* would have "sweeping effects" because "[m]any state programs provide payments to generators that sell exclusively at wholesale, including the REC programs FERC has approved." Ex. Opp. 34. But Petitioners do not contend that *Hughes* preempts *all* state efforts to promote the generation of electricity that will be sold at wholesale; rather, Petitioners argue that any subsidy that violates *Hughes*' prohibition against second-guessing or disregarding FERC-approved wholesale rates is preempted, regardless of whether its receipt is expressly conditioned on wholesale market participation. The formalistic distinction drawn by the court below is inconsistent with *Hughes*. Pet. 24–26. Otherwise, Maryland could proceed with its preempted subsidy program "after a few tweaks to the wording." Monitor Br. 4. Moreover, as the Petition demonstrates, Respondents' constricted reading of *Hughes* is fundamentally incompatible with this Court's approach to preemption. Pet. 24–25. Tellingly, the Illinois Respondents did not argue

that *Hughes* turns on the language of the program rather than how the subsidy operates, and Exelon's one-paragraph response is non-responsive. Ex. Opp. 35. The question is, as the Market Monitor put it, "whether *Hughes* stands for a principle or is limited to semantics." Monitor Br. 4. The Court's preemption jurisprudence makes clear that it must be the former.

5. Respondents persist in disputing the well-pleaded factual allegations of Petitioners' complaint. Ex. Opp. 25–27; Ill. Opp. at 27 n.8. To the extent Respondents claim that Petitioners did not allege certain facts, the complaint speaks for itself, Pet. App. 58a–92a; otherwise, Respondents' arguments are irrelevant in the Rule 12(b)(6) context,[3] see, e.g., *Fitzgerald v. Barnstable Sch. Comm.*, 555 U.S. 249 (2009) ("Because this case comes to us on a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), we assume the truth of the facts as alleged in petitioners' complaint.").

IV. The "Vehicle Problems" Identified by Respondents Are Non-Issues

Respondents claim "two threshold justiciability" questions not addressed by the decision below would hinder the Court's review: (1) whether there is a private cause of action for FPA preemption under *Armstrong v. Exceptional Child Center, Inc.*, 135 S. Ct. 1378 (2015), and (2) whether Petitioners have standing. Ex. Opp. 27–31; Ill. Opp. 14–21. Not so.

[3] *Amici* corroborate the factual allegations Respondents dispute. E.g., Econ. Br. 6–7, 10–13.

1. Because the existence of a cause of action is not a jurisdictional question, see, e.g., *Verizon Maryland, Inc. v. Pub. Serv. Comm'n of Maryland*, 535 U.S. 635, 642–43 (2002), the Court can reach the merits without deciding the *Armstrong* question—as it did in *Hughes* and as the Seventh Circuit did below. It would make little sense for the Court to leave undisturbed an incorrect interpretation of its own decision that is seriously impairing federal energy policy merely because there *might* be another ground for dismissal on remand.

2. Standing *is* a jurisdictional prerequisite, but, unsurprisingly, the Seventh Circuit concluded that its "jurisdiction [wa]s secure." Pet. App. 3a. Petitioners allege that the ZEC subsidy "artificially depress[es]" FERC-mandated auction prices, resulting in "lower revenues" for other generators, thereby causing Petitioners competitive injury. Pet. App. 61–62a, 87a (Compl. ¶¶ 10, 80). These allegations establish injury-in-fact (loss of revenue) that is fairly traceable to the ZEC program and redressable by an injunction against enforcement of that program.

CONCLUSION

The petition for certiorari should be held pending consideration of the petition in *Zibelman*, and should then be decided as appropriate in light of the Court's disposition of that petition. Alternatively, the petition should be granted.

Respectfully submitted,

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