

**A CALL FOR FEDERALISM: THE ROLE OF STATE
GOVERNMENT IN FEDERALLY CONTROLLED ENERGY
MARKETS**

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“[Federalism] is sensitivity to the legitimate interests of both State and National Governments, and in which the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not unduly interfere with the legitimate activities of the States.”

- The Supreme Court of the United States¹

INTRODUCTION	574
I. A HISTORY OF THE ENERGY INDUSTRY	575
A. The Start of Public Utility Regulation	575
B. Federal Intervention	579
C. The Rise of Competitive Markets	584
D. The Modern Market: “Competitive Regulation”	588
II. A FAILED MARKET? JURISDICTIONAL CONFLICT BETWEEN FEDERAL AND STATE REGULATION	591
A. Energy Markets Demystified	593
1. Energy Market	593
2. Capacity Markets	594
B. New Jersey’s LCAPP	597
1. The Mechanics of LCAPP	597
2. Will It Work?	599
C. LCAPP Resistance—FERC Proceedings	601
1. P3 Power Providers Group Complaint	601

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1. *Younger v. Harris*, 401 U.S. 37, 44 (1971).

2. The FERC Decision	602
D. LCAPP Resistance Continued—Is LCAPP Unconstitutional?	606
III. A CONSTITUTIONAL CHALLENGE FOR FEDERALISM AND THE POLICY BEHIND A STATE’S RIGHT TO RELIABLE ENERGY	607
A. The Preemption Doctrine	608
B. Dormant Commerce Clause	618
1. Current Court Standards Under Dormant Commerce Clause Jurisprudence	619
2. An Analysis of LCAPP Under the Commerce Clause and How a State Can Navigate the Dormant Commerce Clause Minefield	625
C. The Role of State Government: A Policy Perspective	630

INTRODUCTION

The role of state regulation in the electricity industry was once well defined. However, over the past one hundred years, federal laws and regulations have slowly eroded the bright lines that once separated federal and state jurisdiction. Regulation of the electricity industry was grounded in safeguarding the public welfare and protecting the public from monopolistic utilities that threatened state security. This obligation to the public was, at one time, the sole province of state governments. Obviously, the electricity industry is not what it was at the turn of the nineteenth century. The invention of new technology transformed the industry from the creation of a single light bulb and turned it into a multibillion-dollar industry, with multistate regional transmission operators and huge generating plants capable of producing thousands of megawatts of electricity. However, even when it was deemed necessary for federal regulation to intervene in areas traditionally left to state police powers, there had always been sensitivity to cooperative federalism. Although it is often taken for granted, electricity is of vital importance to the welfare, safety, and economy of state citizens. Thus, when federal energy markets fail to incentivize sufficient generation capacity and the federal government refuses to correct them, states have no choice but to act unilaterally to protect the public interest.

Part I of this Note will outline the evolution of government regulation of the electric utility industry in the United States. It will begin by explaining the inception of the industry by Thomas Edison and detail the rise of state public utility commissions. It will then show the progression of federal intervention into the market and explain the congressional intent behind federal regulation. Part I ends with an explanation of market restructuring and an analysis of the current market structure—a quasi-competitive market that is still heavily regulated.

Part II begins with a brief explanation of how federal wholesale markets work. It then highlights New Jersey's recent bill to subsidize new generation. The bill, titled the "Long-Term Capacity Agreement Pilot Program" ("LCAPP"), was a response to capacity shortfalls that were causing serious congestion and reliability issues that would harm the welfare of New Jersey citizens. The use of LCAPP and the PJM energy markets provides an important example of the growing conflict across the country. Part II ends with an analysis of the current litigation surrounding New Jersey's program and how the litigation will effect future state initiatives that wish to subsidize new generation in response to failing federally mandated markets.

Lastly, Part III examines both the preemption doctrine and the dormant commerce clause and the effect they could have on New Jersey's LCAPP and other future state initiatives to create new generation. Drawing on principles of federalism, Part III concludes with a policy argument contending that states must have the right to unilaterally encourage generation, especially if there is a capacity shortfall that could endanger the safety and welfare of the state.

I. A HISTORY OF THE ENERGY INDUSTRY

A. *The Start of Public Utility Regulation*

The purpose for regulating public utilities can be dated back to England around 1670 when England's Lord Chief Justice Matthew Hale observed that services that were essential to a country's infrastructure and well-being no longer enjoy the same freedoms as private businesses.² Instead, he found these essential services to be "affected with a public interest."³ Because of the vital nature of these services, the government had a proper and necessary reason to regulate them to ensure reliable service at a reasonable price.⁴ In 1876, a little over 200 years later, the Supreme Court adopted Justice Hale's words in *Munn v. Illinois*.⁵ In *Munn*, the Court established the principle that services, which are both "necessary" to society and a natural monopoly, constitute a special category of businesses—the public utility.⁶

2. RICHARD F. HIRSH, POWER LOSS: THE ORIGINS OF DEREGULATION AND RESTRUCTURING IN THE AMERICAN ELECTRIC UTILITY SYSTEM 16 (1999).

3. *Id.*

4. *Id.*

5. 94 U.S. 113, 126-28 (1876). Congress formally adopted the notion that electric utilities are "affected with a public interest" in the Federal Power Act. 16 U.S.C. § 824(a) (2006) ("It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public *is affected with a public interest*" (emphasis added)).

6. 94 U.S. at 126-28 ("When . . . one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the

In the late nineteenth and early twentieth centuries, the emergence of the electric industry took form. Thomas Edison established the first electric utility in 1882 in the financial district of New York.⁷ Edison's goal was to introduce a "system of lighting" that could light up entire cities, powered by small, centralized generators.⁸ However, Edison's first utility was limited to a small area and to few customers due to technological deficiencies.⁹ It was not until the discovery of two industry-altering inventions, the steam turbine and alternating current ("AC"), that electric generation became truly centralized and economies of scale could be exploited.¹⁰ From these innovations sprung the ability of electric utilities to expand service area, and the incentives to monopolize the market grew.

Under *Munn*, a service could only be regulated if it was vital to society and a natural monopoly.¹¹ The vital importance of electricity

interest he has thus created."). *Munn* is considered the "root source" that established regulation of public utilities in the United States. Robert L. Swartwout, *Current Utility Regulatory Practice from a Historical Perspective*, 32 NAT. RESOURCES J. 289, 296 (1992).

7. HIRSH, *supra* note 2, at 12.

8. DANIEL YERGIN, *THE QUEST: ENERGY, SECURITY, AND THE REMAKING OF THE MODERN WORLD* 347-49 (2011).

9. *See id.* at 349.

10. HIRSH, *supra* note 2, at 13; *see also* YERGIN, *supra* note 8, at 349-50 (noting that "[a] transformer would step up electricity to much higher voltage, which meant it could be economically transported long distances over transmission lines").

11. A natural or virtual monopoly is the idea that a perfectly competitive market is unattainable because the market is intrinsically broken and will fail. Gregg A. Jarrell, *The Demand for State Regulation of the Electric Utility Industry*, 21 J.L. & ECON. 269, 272 (1978). In competitive markets, suppliers price their goods or services at marginal cost. If the price is not set at marginal costs—for example, if a supplier increases prices—the lure of profits will result in new firms entering the market, and the increase in supply will drive the price down to marginal cost. In the case of natural monopolies, however, the competitive market is broken because the market can be served at a lower average cost by a single firm rather than by two or more firms. *See id.* This can be due to natural barriers to entry, such as large capital investments in generating plants and transmission networks, which can handicap new entrants. *See* Swartwout, *supra* note 6, at 292 ("Our electric utilities require more capital than does any other single industry."). In this case, the incumbent firm could increase its production or sales at a lower average cost than a new entrant, which would have to build similar generating and transmission facilities to compete for the same customers. Additionally, the building of these investments is wasteful. It is uneconomical to build two transmission lines right next to each other when only one is necessary. The theory predicts that the industry will naturally form a monopoly because of "cutthroat price competition and consolidations." Jarrell, *supra*, at 272; *see also* Swartwout, *supra* note 6, at 300 ("[T]he competition between the utilities that was supposed to protect the public interest turned cut-throat; abuses included price discrimination, price undercutting and price fixing. Cartelization and combination resulted and the utility type monopoly emerged anyway.").

to the economy and society is well established;¹² however, the consensus that the electricity industry was a natural monopoly grew around the turn of the nineteenth century when Samuel Insull developed what would become the biggest electric utility in Chicago.¹³ By building a steam turbine capable of producing 5,000 kilowatts (“kW”), which was later expanded to 12,000 kW in 1911, and using AC transformers, Insull was capable of selling electricity throughout the city and the surrounding area.¹⁴ As time passed, Insull bought out any competing utilities and consolidated their generating and transmission facilities.¹⁵ From 1882 to 1905, there were forty-five competing electric utility franchises in Chicago; however, by 1905 Insull had brought all of them under control of his Chicago Edison utility.¹⁶ This allowed him to solidify his monopoly while expanding service to an ever-growing customer base.¹⁷

By the turn of the century, the groundwork and rationale for state regulation of monopoly utilities had been well established. Starting with the grain elevators in *Munn v. Illinois*, the consensus was to move to a comprehensive state regulatory administration that would oversee all public utilities in the state including railroads, bridges, and gas and water supplies.¹⁸ In *Smyth v. Ames*, the Supreme Court supported regulation by state commissions.¹⁹ By holding that a regulated company is entitled to a “fair return upon

12. Without electricity, consider what modern society would look like. At the turn of the twentieth century, the potential of electric energy was only first becoming realized. Standing at the turn of the twenty-first century, we can see that electricity permeates every aspect of our lives. David Yergin summarizes this idea nicely:

Consider what would not work and would not happen without electric power. Obviously, no refrigerators, no air-conditioning, no television, no elevators. It is essential for every kind of industrial processing. The new digital world relies on electricity’s precision to drive everything that runs on microprocessors—computers, telephones, smart phones, medical equipment, espresso machines. Electricity makes possible and integrates the real-time networks of communications, finance, and trade that shape the world economy. And its importance only grows, as most new energy-consuming devices require electricity.

YERGIN, *supra* note 8, at 345 (citations omitted).

13. HIRSH, *supra* note 2, at 13.

14. *Id.*

15. *Id.*

16. Swartwout, *supra* note 6, at 299; YERGIN, *supra* note 8, at 350-53.

17. See HIRSH, *supra* note 2, at 13-14; see also Douglas D. Anderson, *State Regulation of Electric Utilities*, in *THE POLITICS OF REGULATION* 3, 5 (James Q. Wilson ed., 1980) (noting that in 1892, when electric utilities started to proliferate, only five thousand people were using electricity out of a population of one million).

18. See HIRSH, *supra* note 2, 18-23.

19. See 169 U.S. 466, 527 (1898), *overruled on other grounds by* Fed. Power Comm’n v. Natural Gas Pipeline Co. of Am., 315 U.S. 575 (1942); Swartwout, *supra* note 6, at 300 (“The *Smyth v. Ames* decision . . . clearly stated that the path to commission type regulation was the best way to go.”).

the value of that which it employs for the public convenience,”²⁰ the Court found that a state could ensure due process by appointing a commission “composed of persons whose special skill, observation, and experience qualifie[d] them” to balance the public good with the financial needs of the investors.²¹

Before 1907, electric utilities were incorporated under the laws of the state where they were located.²² However, unlike other corporations, which only needed the state-granted franchise, public utilities needed special franchises granted from the municipality where they provided service.²³ Although municipalities tried to give out competing franchises to any utility that wanted one,²⁴ the inevitable result was that the utilities eventually consolidated due to the industry being a natural monopoly.²⁵ Furthermore, as franchise competition gave way to monopolized electrical utilities, critics of municipal regulation believed that regulators became corrupt.²⁶ These beliefs came to fruition when an investigation of the electric utilities in New York City, led by Charles Hughes, uncovered “[t]he gross abuse of legal privilege in overcapitalization and in the manipulation of securities, for the purpose of unifying control and eliminating all possible competition.”²⁷ Hughes went on to win the governorship of New York in 1906, and in about a year and a half, he signed into law what would become New York’s first two public utility commissions—one for New York City and the other for the rest of the state.²⁸

Concurrently, similar legislation was being passed in Wisconsin.²⁹ The Wisconsin public utility law was the product of the doctrine expounded in the decisions of *Munn v. Illinois* and *Smyth v. Ames*.³⁰ Acknowledging that electricity was both necessary to society and a natural monopoly, Wisconsin’s law granted broad powers to the state commission to ensure reliable service at a fair price.³¹ The Wisconsin law went above and beyond the New York law in two

20. *Smyth*, 169 U.S. at 547.

21. *Id.* at 527; see also *infra* text accompanying note 72 (explaining the three interests state commissions are supposed to protect).

22. Jarrell, *supra* note 11, at 270.

23. *Id.*

24. R. Richard Geddes, *A Historical Perspective on Electric Utility Regulation*, 15 REG. 75, 75 (1992) (stating the consensus at the time was the “practice created vigorous competition”).

25. Jarrell, *supra* note 11, at 273.

26. *Id.* at 274.

27. Anderson, *supra* note 17, at 13-15 (internal citation omitted).

28. HIRSH, *supra* note 2, at 21.

29. *Id.*

30. Ari Peskoe, Note, *A Challenge for Federalism: Achieving National Goals in the Electricity Industry*, 18 MO. ENVTL. L. & POL’Y REV. 209, 213-14 (2011).

31. HIRSH, *supra* note 2, at 22.

respects. First, the Wisconsin law gave the commission full control over the rates charged by state utilities. These rates were based on a “valu[ation] of the utility’s property actually used” for public service.³² By giving the commission power to set “absolute rates,” and not merely “maximum rates [like] in New York,” the Wisconsin statute endeavored to end price discrimination.³³

Second, the law gave public utilities “indeterminate permits,” as opposed to “limited term franchises,” which had been the custom during municipal regulation.³⁴ The indeterminate permits gave the utilities a guaranteed monopoly over a certain service area in return for an obligation to provide fair and adequate service to the public.³⁵ These permits allowed developers to obtain capital to build expensive generating and transmission facilities by reducing investors’ fears that the utilities’ legal monopoly would be revoked after the franchise expired.³⁶ However, to enforce the obligation of utilities, the law gave municipalities the ability to buyout utilities that failed to provide reliable service, thereby giving the utilities the incentive to provide quality service to avoid dissolution.³⁷ The Wisconsin law was viewed as revolutionary, and “[u]tility regulation as it is known today dates from this legislation.”³⁸ By the 1920s, almost every state had a public utility commission, and the Wisconsin law was the most frequently used model.³⁹

B. Federal Intervention

From its inception, the electricity industry was vertically integrated, with a single company controlling the generation, transmission, and distribution systems that delivered electricity to end-users.⁴⁰ The use of state-backed indeterminate monopolies allowed utilities both to more easily acquire investment capital by reducing financial risk and also to expand.⁴¹ From 1901 to 1932, the electric industry grew an average of twelve percent per year.⁴²

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. *See id.*

38. *Id.* at 22-23.

39. Swartwout, *supra* note 6, at 301.

40. Severin Borenstein & James Bushnell, *Electricity Restructuring: Deregulation or Reregulation?*, 23 REG. 46, 46 (2000) (noting vertically integrated firms have either been “investor-owned and state-regulated or owned by the local municipality”).

41. Peskoe, *supra* note 30, at 217 (citing HIRSH, *supra* note 2, at 34).

42. *History of the U.S. Electric Power Industry, 1882-1991*, U.S. ENERGY INFO. ADMIN., http://www.eia.gov/cneaf/electricity/chg_stru_update/appa.html (last visited Mar. 18, 2013) [hereinafter *History of Power Industry*].

Electricity prices also dropped during this period, with residential prices in 1932 being a third of what they were at the turn of the century.⁴³

In 1920, the first major piece of federal legislation over the electricity industry emerged. The Federal Water Power Act of 1920 was significant because it carved out a portion of jurisdiction to be regulated by the federal government.⁴⁴ The Act created the Federal Power Commission ("FPC"), which would eventually become the Federal Energy Regulatory Commission ("FERC" or "the Commission"), to oversee the regulatory obligations.⁴⁵ However, the Act only granted the FPC jurisdiction over hydroelectric dams on navigable waters. The FPC jurisdiction included backstop authority—in the absence of relevant state law—to regulate rates and other matters related to electricity generated from these dams.⁴⁶ This regulation would eventually make up Title I of the Federal Power Act.⁴⁷

The catalyst for greater federal involvement in the electric industry was produced by two gaps that emerged after the enactment of the Federal Water Power Act. The first was the result of the Great Depression, which destabilized part of the industry and required federal intervention.⁴⁸ The second was a jurisdictional gap created by an ever-expanding electricity industry that eventually convoluted state jurisdictional lines.⁴⁹

First, the electricity industry was capital intensive, and growth was financed either with sales of stock (equity) or with bonds (debt).⁵⁰ To help secure capital, many utilities assembled into holding companies.⁵¹ The rise of holding companies was striking, with the sixteen biggest holding companies controlling seventy-five percent of all generation in the United States by 1932.⁵² The depression of the 1930s put this structure under stress, and Congress reacted by implementing the Public Utility Holding Company Act of 1935

43. *Id.*

44. Federal Water Power Act, ch. 285, § 1, 41 Stat. 1063, 1063 (1920) (current version at 16 U.S.C. § 792 (2006)).

45. *Id.*

46. Peskoe, *supra* note 30, at 218.

47. *See* Federal Power Act, 16 U.S.C. §§ 791a-823 (2006).

48. Peskoe, *supra* note 30, at 217-18; *see also* YERGIN, *supra* note 8, at 355-57 (detailing how the collapse of Insull's empire during the Great Depression led to political and public outcry to change how the electric industry was regulated and the subsequent enactment of the Public Utility Holding Company Act of 1935).

49. Peskoe, *supra* note 30, at 219.

50. *Id.* at 217.

51. *Id.*

52. Swartwout, *supra* note 6, at 307.

(“PUHCA”).⁵³ This Act gave the Securities and Exchange Commission the task of regulating utility holding companies and eliminating their financial abuses.⁵⁴ The response of the federal government was necessary because these holding companies spanned several states and it was unconstitutional and unreasonable to expect state public utility commissions to respond effectively to the problem.

Second, the “Attleboro Gap” resulted from the historic case of *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.*⁵⁵ The case involved a corporation that generated electricity in Rhode Island but sold it to a customer in Massachusetts.⁵⁶ The Massachusetts customer appealed a rate increase,⁵⁷ which the Rhode Island Public Utility Commission had ordered as fair and reasonable.⁵⁸ The customer claimed the state commission had no jurisdiction to approve rates for an interstate sale.⁵⁹ The claim was fought all the way to the Supreme Court, where the Court held the state commission’s order was “the imposition of a direct burden upon interstate commerce, from which the state is restrained by the force of the commerce clause, [and] it must necessarily fall, regardless of its purpose.”⁶⁰ The Court concluded that neither Rhode Island nor Massachusetts had the authority to regulate such interstate transactions and “if such regulation is required it can only be attained by the exercise of the power vested in Congress.”⁶¹

In response to the lack of jurisdiction revealed by the Supreme Court, Congress expanded the Federal Water Power Act, renamed

53. Public Utility Act of 1935, ch. 687, 49 Stat. 803 (repealed 2005).

54. Swartwout, *supra* note 6, at 307 (“The business practices of these utility holding company systems are some of the most blatant examples of insider control and self-seeking.”). President Roosevelt favored passage of the PUHCA because he claimed utility “holding companies diverted the excessive profits from their regulated utilities to fund investments in their unregulated enterprises.” Thomas P. Lyon & Nathan Wilson, *Capture or Contract?: The Early Years of Electric Utility Regulation* 4 (Aug. 2010) (unpublished manuscript), available at <http://webuser.bus.umich.edu/tplyon> (follow “Working Papers” hyperlink; then follow “Capture or Contract?” hyperlink).

55. 273 U.S. 83 (1927). This jurisdictional gap was termed the “Attleboro Gap” by the Supreme Court in *New York v. Federal Energy Regulatory Commission*, 535 U.S. 1, 6 (2002).

56. *Attleboro*, 273 U.S. at 84-85.

57. *Id.* at 86.

58. *Id.*

59. *See id.*

60. *Id.* at 89. Distinguishing a difference between indirect and direct burden on interstate commerce, the Court found that the rate increase was direct because it only increased the rate for the Attleboro customers and not the other in-state customers. *Id.* This distinction was ultimately abrogated by *Quill Corp. v. North Dakota*, 504 U.S. 298, 316-17 (1992).

61. *Attleboro*, 273 U.S. at 90.

the Federal Power Act (“FPA”), by adding Title II: “Regulation of Electric Utility Companies Engaged in Interstate Commerce.”⁶² Title II expanded the authority of the FPC and granted them jurisdiction over “transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce” and “over all facilities for such transmission or sale of electric energy.”⁶³ However, it was not Congress’s intent to supersede the states’ jurisdictions but only to give the FPC jurisdiction when there was an absence of state jurisdiction—i.e., to fix the jurisdictional conflict exposed in *Attleboro*.⁶⁴ The FPA explicitly states that federal regulation is extended “only to those matters which are not subject to regulation by the states.”⁶⁵ Furthermore, Title II states that the Commission “shall not have jurisdiction . . . over facilities used for the *generation* of electric energy or over facilities used in local distribution.”⁶⁶

Shortly after passage of the FPA, there were two important Supreme Court cases examining the congressional intent of Title II. First, in *Jersey Central Power & Light Co. v. FPC*, the Court found “[t]he primary purpose of Title II . . . was to give a federal agency power to regulate the sale of electric energy across state lines.”⁶⁷ Then in *Connecticut Light & Power Co. v. FPC*, the Court quoted a commissioner of the FPC in a hearing before the House Committee on Interstate and Foreign Commerce as saying “[t]he new title II of the act is designed to . . . fill the gap in the present State regulation of electric utilities. It is conceived entirely as a supplement to, and not as a substitution for State regulation.”⁶⁸ Elaborating, a House report noted:

The new parts are so drawn as to be a complement to and in no sense a usurpation of State regulatory authority and contain throughout directions to the Federal Power Commission to receive and consider the views of State commissions. Probably, no bill in recent years has so recognized the responsibilities of State regulatory commissions as does title II of this bill.⁶⁹

62. Federal Power Act, ch. 687, § 213, 49 Stat. 847 (1935) (current version at 16 U.S.C. § 824 (2006)).

63. 16 U.S.C. § 824(b)(1) (2006). A wholesale transaction is “a sale of electric energy to any person for resale.” § 824(d). A retail sale is a sale directly to an end-user. See *Panhandle E. Pipe Line Co. v. Pub. Serv. Comm’n*, 332 U.S. 507, 517 n.12 (1947).

64. See § 824(a).

65. *Id.*

66. § 824(b)(1) (emphasis added).

67. 319 U.S. 61, 67-68 (1943) (noting that regulation by states had been denied in *Attleboro* and Congress had wanted to fill this regulatory void).

68. 324 U.S. 515, 525 (1945) (quoting *Hearings on H.R. 5423 Before the H. Comm. on Interstate and Foreign Commerce*, 74th Cong. 384 (1935) (statement of Clyde L. Seavey, Comm’r, Federal Power Commission)) (internal quotation marks omitted).

69. *Id.* at 526 (quoting H.R. REP. NO. 74-1318, at 7, 8, 27 (1935)).

Additionally, another House Report on a revised version of the Title II bill declared “the policy of Congress [was] to extend . . . regulation to those matters which cannot be regulated by the States and to assist the States in the exercise of their regulatory powers, but not to impair or diminish the powers of any State commission.”⁷⁰

Therefore, one of the intentions of the FPA was to draw a bright line distinguishing state and federal jurisdiction.⁷¹ State commissions would preserve their historic role of administering the “regulatory compact” between investor owned utilities, ratepayers, and investors⁷² by approving retail rates, retaining the power to determine siting and “need” for new generation, and regulating various aspects of utility securities and financing.⁷³ It would then be the job of the federal government to step in to regulate wholesale rates in interstate commerce.

After the passage of the FPA, the period from 1945-1970 remained relatively uneventful for the electric utility industry. Demand for electricity during this period “grew rapidly, consistently, and predictably, while electricity prices continued to fall.”⁷⁴ From 1945-1970, generation grew an average of 7.5-8.5% annually, while capacity grew at a similar rate.⁷⁵ One explanation for the rapid growth is the many New Deal programs and agencies, like the Rural Electrification Act of 1936 and the Tennessee Valley Authority, which enveloped rural communities and expanded federally produced

70. *Id.* (quoting S. REP. NO. 74-621, at 48 (1935)).

71. *Fed. Power Comm'n v. S. Cal. Edison Co.*, 376 U.S. 205, 215-16 (1964) (holding “Congress meant to draw a bright line” between federal and state jurisdiction by granting plenary jurisdiction to the FPC over all interstate wholesale sales “except those which Congress has made explicitly subject to regulation by the States”); *Peskoe*, *supra* note 30, at 221-22, 247.

72. *See Swartwout*, *supra* note 6, at 303 (explaining that under current and traditional public utility laws, state commissions are to protect three interests: “(1) the interests of utility customers, (2) the interests of the investors in the utility, and (3) the interest of the general public”); *see also* *Peskoe*, *supra* note 30, at 222 (“State commissions were the primary administrators of the ‘regulatory compact’ between utilities, customers and investors, and had broad authority to regulate nearly all aspects of a utility’s business, including setting rates for all intrastate sales and approving the siting of new facilities.”).

73. *See Swartwout*, *supra* note 6, at 305 (explaining the three major areas of utility regulation: rates, certificates of public convenience (also referred to as “need”), and utility securities and financing); *see also, e.g.*, *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 205 (1983) (“Need for new power facilities, their economic feasibility, and rates and services, are areas that have been characteristically governed by the States.”); *Tampa Elec. Co. v. Garcia*, 767 So. 2d 428, 436 (Fla. 2000) (“[W]e find that power-plant siting and need determination are areas that Congress has expressly left to the states.”).

74. *History of Power Industry*, *supra* note 42, at 3; *see also* *Geddes*, *supra* note 24, at 77 (outlining the “[e]conomic [c]hange and [i]ndustry [c]osts” from 1950-1970).

75. *History of Power Industry*, *supra* note 42, at 3.

generation, transmission, and distribution.⁷⁶ Additionally, the Atomic Energy Act of 1954⁷⁷ and the development of nuclear power augmented the power industry with theoretically cheap and abundant power.⁷⁸ With the rise of nuclear power came the Atomic Energy Commission (now the Nuclear Regulatory Commission) and federal regulation over licenses and safety for nuclear plants.⁷⁹ However, the Atomic Energy Commission, much like the Federal Power Commission, “was not given authority over the generation of electricity itself, or over the economic question whether a particular plant should be built.”⁸⁰ Although there were many new federal agencies created during this period, none of them changed the regulatory landscape significantly or shifted the jurisdictional lines between federal and state governments.

C. *The Rise of Competitive Markets*

After forty-three years, the “golden age” of electricity came to an end.⁸¹ A culmination of increased fuel costs,⁸² environmental standards,⁸³ and failed investments⁸⁴ created an industry that was

76. *See id.* at 2-3.

77. Atomic Energy Act of 1954, ch. 1073, § 1, 68 Stat. 919 (1954) (codified as amended in scattered sections of 42 U.S.C.).

78. The chairman of the Atomic Energy Commission, Lewis L. Strauss, stated during an address before the National Association of Science Writers that “[o]ur children will enjoy in their homes electrical energy too cheap to meter.” Richard D. Cudahy, *The Choice of Fuel in Competitive Generation*, PUB. UTIL. FORT., June 1995, at 35 (quoting Lewis L. Strauss, Chairman, Atomic Energy Commission, Address before the National Association of Science Writers (Sept. 16, 1954)).

79. CHARLES F. PHILLIPS, JR., *THE REGULATION OF PUBLIC UTILITIES* 579-80 (1993).

80. *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 206-07 (1983) (“There is little doubt that under the Atomic Energy Act of 1954, state public utility commissions or similar bodies are empowered to make the initial decision regarding the need for power.” (quoting *Vt. Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc.*, 435 U.S. 519, 550 (1978))). The Atomic Energy Act and the Federal Power Act contain similar limiting language with respect to the jurisdiction of their respective federal regulatory commissions. *Compare* 42 U.S.C. § 2018 (2006) (“Nothing in this chapter shall be construed to affect the authority or regulations of . . . [a] State, or local agency with respect to the generation, sale, or transmission of electric power produced through the use of nuclear facilities licensed by the Commission . . .”), *with* 16 U.S.C. § 824(b)(1) (2006) (“The Commission . . . shall not have jurisdiction . . . over facilities used for the generation of electric energy or over facilities used in local distribution . . .”).

81. *See* ROBERT HYMAN ET AL., *AMERICA’S ELECTRIC UTILITIES: PAST PRESENT AND FUTURE* 111, 151 (8th ed. 2005).

82. The oil embargo and resultant energy crisis in the 1970s led to increases of fuel and financing costs, which subsequently increased electricity costs resulting in decreased demand. As growth slowed to a crawl, the system of building new capacity to compensate for the increased demand no longer worked. HIRSH, *supra* note 2, at 59-63.

83. The rising environmental movement resulted in increased stress on industry

unstable and costly. To make up for their increased fixed and variable costs, electric utilities requested and received rate increases that resulted in an unprecedented drop in demand, revealing that there was more price elasticity than previously assumed.⁸⁵ Furthermore, a northeastern blackout in 1965 exposed reliability concerns of the large “interconnected, interdependent power networks.”⁸⁶ In 1978, Congress adopted the Public Utility Regulatory Policies Act of 1978 (“PURPA”) as part of President Carter’s national energy plan.⁸⁷ The primary purpose of PURPA was to increase conservation and efficiency of electric energy by moving toward marginal cost pricing and incentivizing new generation in the hopes that it would decrease energy costs while increasing reliability.⁸⁸ However, the actual effect of PURPA would significantly change the structure of the entire electricity industry.

The vertically integrated utility had been the backbone of the utility industry from the beginning. However, PURPA would be the catalyst by which this traditional structure would disintegrate.⁸⁹ First, § 210 of PURPA would amend the FPA and authorize the

and caused increased costs for utilities, which had to respond to over forty environmental laws from 1969 to 1980, including the National Environmental Policy Act passed in 1969, Clean Air Act Amendments of 1970, the Water Pollution Control Act Amendments in 1972, and the Clean Water Act of 1977. See Hirsh, *supra* note 2, at 63-65, 69. This list excludes similar state legislation, which sometimes imposed even more stringent standards. *Id.*

84. Many of the failed investments were in nuclear power. The primary cause of nuclear plant failure was capital costs, which “rose from . . . \$150 per kilowatt [hour] in 1971 to more than \$600 [per kilowatt hour] after 1976.” *History of Power Industry, supra* note 42, at 4. Another cause was increased environmental activism, which heavily protested the building of new plants. HIRSH, *supra* note 2, at 66. Besides the environmental protests concerning nuclear waste, there were other safety concerns, especially following the first nuclear accident to hit the country at Three Mile Island in 1979. *History of Power Industry, supra* note 42, at 4. The increased capital costs, decreased demand, and worsening public opinion caused demand for nuclear plants to drop quickly, resulting in sixty-three plants canceled between 1975 and 1980 alone. *Id.*

85. JOSEPH P. TOMAIN & RICHARD D. CUDAHY, ENERGY LAW IN A NUTSHELL 379 (2d ed. 2011). *But see, e.g.*, Steven Ferrey, *Sustainable Energy, Environmental Policy, and States’ Rights: Discerning the Energy Future Through the Eye of the Dormant Commerce Clause*, 12 N.Y.U. ENVTL. L.J. 507, 510 (2004) (stating “[e]lectricity is the least price-elastic of all energy commodities” because of its vital nature in the economy); David B. Spence, *The Politics of Electricity Restructuring: Theory vs. Practice*, 40 WAKE FOREST L. REV. 417, 437 (2005) (finding price elasticity is low for electricity “because some consumers cannot effectively substitute other energy sources for electricity, at least in the short term”).

86. *History of Power Industry, supra* note 42, at 3.

87. Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, § 2, 92 Stat. 3117 (codified at 16 U.S.C. § 2601 (2006)); HIRSH, *supra* note 2, at 73-74.

88. § 2; HIRSH, *supra* note 2, at 74-77.

89. HIRSH, *supra* note 2, at 119 (“Through its mostly unintended consequences, PURPA inaugurated the process by which the traditional structure of the utility system disintegrated.”).

FERC to promulgate rules that would require utilities to purchase or sell electricity from nonutility owned cogeneration facilities and small power generators (eighty megawatts or less) (collectively called Qualified Facilities or QFs).⁹⁰ Utilities were required to purchase the power from these QFs at full avoided cost, meaning these utilities had to buy the new energy not at the prevailing market rate, but at the utility's own cost of producing electricity, which was quite high.⁹¹ Because utilities were prohibited from owning this new class of generation, PURPA would effectively break down the barriers to generation that the traditional, vertically integrated utilities had monopolized.

Second, according to the promulgated rules, the states and federal government were to share the responsibility of implementing this mandate. FERC would determine whether a facility qualified as a QF, and the state commissions would then decide what constituted avoided costs for the utilities that they regulated.⁹² Since states were given wide latitude with how to determine avoided costs, many of them opted for free-market procedures that would "offer[] the best combination of low price and desirable performance . . . to meet projected demand."⁹³

The constitutionality of PURPA was challenged in the seminal case of *FERC v. Mississippi*.⁹⁴ The new legislation was challenged as a violation of the Commerce Clause⁹⁵ and the Tenth Amendment.⁹⁶ Concerning the Commerce Clause, the Court held that Congress did not exceed its power because the nature of generation and transmission is inherently interstate⁹⁷ and the Legislature had a

90. 18 C.F.R. § 292.303 (2012). Requirements to qualify as a QF are defined under 18 C.F.R. § 292.203.

91. See *What Are the Benefits of QF Status?*, FED. ENERGY REG. COMMISSION <http://www.ferc.gov/industries/electric/gen-info/qual-fac/benefits.asp> (last updated Feb. 3, 2012) ("QFs generally have the option of selling to a utility either at the utility's avoided cost or at a negotiated rate."). Avoided cost is defined as "the incremental costs to an electric utility of [the] electric energy or capacity or both which, but for the purchase from [such cogeneration or small power facilities], such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101(b)(6) (2012).

92. See generally 18 C.F.R. § 292; *Plymouth Rock Energy Ass'n v. Dept. of Pub. Util.*, 420 Mass. 168, 170 (1995) ("FERC has granted the States flexibility in . . . determining avoided costs.").

93. HIRSH, *supra* note 2, at 119. For a discussion on states' roles in implementing § 210 of PURPA, see Deirdre Callaghan & Steve Greenwald, *PURPA from Coast to Coast: America's Great Electricity Experiment*, 10 NAT. RESOURCES & ENV'T 17 (1996).

94. 456 U.S. 742 (1982).

95. *Id.* at 754 ("[A]ppellees assert[ed] that PURPA [was] facially unconstitutional because it [did] not regulate 'commerce'; instead . . . the Act direct[ed] the nonconsenting State to regulate in accordance with federal procedures.").

96. *Id.* at 752.

97. *Id.* at 755-57; see also *FPC v. Fla. Power & Light Co.*, 404 U.S. 453 (1972) (holding the transfer of electricity between Florida power companies, commingled with

rational basis for implementing PURPA due to the instability of the energy industry.⁹⁸ The Tenth Amendment was a trickier question,⁹⁹ but the Court nonetheless held that PURPA did not violate states' rights.¹⁰⁰ Concerning § 210, the Court found that "[i]nsofar as § 210 authorizes the FERC to exempt qualified power facilities from 'State laws and regulations,' it does nothing more than pre-empt conflicting state enactments in the traditional way."¹⁰¹ Furthermore, the Court found that had Congress been inclined, they could have completely preempted the field of electric regulation, at least for private activity; however, Congress chose to implement a "less intrusive scheme," which showed deference to state authority and would allow states to continue regulation of public utilities.¹⁰² Accordingly, the Court found that PURPA established "a program of cooperative federalism that allows the States, within limits established by federal minimum standards, to enact and administer their own regulatory programs, structured to meet their own particular needs."¹⁰³

PURPA's success had shown that traditional regulation had run its course. In economic terms, by the time PURPA was adopted, the electric industry had reached the end of its scale economies.¹⁰⁴ What was needed was a jump-start to the industry that would allow new entrants to enter the market and compete with the incumbent utilities by producing energy at an efficient and cheaper rate. PURPA was the answer, and by the 1990s, independent power producers created nearly ten percent of total generation, up from only three percent in the 1980s.¹⁰⁵ Although increasing competition in generation was not something envisioned by Congress when they passed PURPA, it is nonetheless considered a positive externality

power transfers to a Georgia company, making it inherently interstate).

98. *FERC*, 456 U.S. at 755-57.

99. *See id.* at 758-59 (determining whether the federal government may use state regulatory agencies to advance federal goals presented an issue of first impression).

100. *Id.* at 769 (holding that "Titles I and III do not involve the compelled exercise of Mississippi's sovereign powers").

101. *Id.* at 743.

102. *Id.* at 765.

103. *Id.* at 767 (quoting *Hodel v. Va. Surface Min. & Reclamation Ass'n*, 452 U.S. 264, 289 (1981)).

104. *See generally* Laurits R. Christensen & William H. Greene, *Economies of Scale in U.S. Electric Power Generation*, 84 J. POL. ECON. 655 (1976) (finding that by the end of the golden era there were no longer economies of scale and disintegration of utilities would be a rational fix).

105. *See History of Power Industry*, *supra* note 42; *Peskoe*, *supra* note 30, at 230-31 (detailing the growth of small generating facilities and the reduction of fossil fuels used in generation). *But see* Borenstein & Bushnell, *supra* note 40, at 47 (criticizing PURPA by contending it served only to raise prices and the uneconomic PURPA contracts were "the primary reason[] that some states found themselves in the 1990s with electricity prices that were well above . . . building and operating" costs of new power plants).

from the legislation.¹⁰⁶ PURPA challenged the theory that the electricity industry was a natural monopoly,¹⁰⁷ at least insofar as generation was concerned, and as PURPA laid the groundwork for the disbandment of monopoly control enjoyed by regulated utilities, a new era of competitive markets would rise from its ashes.

*D. The Modern Market: "Competitive Regulation"*¹⁰⁸

It is at this point in the regulatory timeline that transmission became important. Although PURPA opened up the industry to competition—at least for generation—transmission and distribution was, and still is, considered a natural monopoly.¹⁰⁹ This created two problems that regulators had to face in order to continue fostering competition. First, regulators had to implement a system that allowed open access to transmission systems, and second, they had to find a way to deal with reimbursing transmission owning utilities for the capital investments that had incurred, also known as stranded costs.¹¹⁰

In response to the first issue, two things were made clear after the passage of PURPA. First, there was an apparently abundant source of cheap generation that was being produced by nonutility generators, and these entities wanted clear access to the market.¹¹¹ Second, "wheeling" authority was needed to force the local utilities to give unencumbered access to their private transmission lines.¹¹² Obviously, these utilities would not want to willingly open their private lines for use by their competitors. In order to address these impediments and create a more robust competitive wholesale market, Congress passed the Energy Policy Act of 1992 ("EPAct of 1992").¹¹³

First, the EPAct of 1992 exempted firms that exclusively sold energy at wholesale from the PUHCA ownership restrictions. These independent power producers were called exempt wholesale

106. Joseph T. Kelliher, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26 ENERGY L.J. 1, 7 (2005).

107. HIRSH, *supra* note 2, at 119.

108. Ferrey, *supra* note 85, at 597 (coining the term "competitive regulation").

109. See Kelliher, *supra* note 106, at 6.

110. TOMAIN & CUDAHY, *supra* note 85, 384-85. The topic of stranded costs is beyond the scope of this Note. However, there is still a flurry of litigation and regulation as to who must pay for stranded costs. For discussion on this issue, see J. GREGORY SIDAQ & DANIEL F. SPULBER, *DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT* (2d ed. 1998); Timothy J. Brennan & James Boyd, *Stranded Costs, Takings, and the Law and Economics of Implicit Contracts*, 11 J. REG. ECON. 41 (1997).

111. See HIRSH, *supra* note 2, at 123 (stating that "nonutility players could produce electricity as cheaply as (or cheaper than) regulated power companies").

112. TOMAIN & CUDAHY, *supra* note 85, at 386.

113. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (1992) (codified as amended in scattered sections of 26 U.S.C.).

generators (“EWGs”).¹¹⁴ Previously, PUHCA placed impediments on nonutility generation that restricted free access to the market.¹¹⁵ The creation of the EWGs would set the stage for the creation of a more competitive, and unregulated, wholesale energy market. Second, prior to PURPA, the FPA was held to exclude the FPC’s ability to order transmission owners to open their lines to other power producers.¹¹⁶ Thus, PURPA and subsequent legislation expanded and streamlined authority for FERC to mandate wheeling by utilities.¹¹⁷

FERC implemented the congressional mandate in EPAct of 1992 by releasing FERC Order 888.¹¹⁸ To further competition in generation, Order 888 prohibited “owners and operators of monopoly transmission facilities from denying transmission access, or offering only inferior access, to other power suppliers in order to favor the monopolists’ own generation and increase monopoly profits.”¹¹⁹ Furthermore, the Order required utilities to “functionally unbundle” their transmission service by separating transmission rates from rates for their generation and ancillary services.¹²⁰ This mandated utilities to file open access transmission tariffs with the Commission stating the price of wholesale generation and transmission.¹²¹ The purpose of this mandate was to prevent self-dealing by ensuring the unbundled utilities transmitted competitors’ electricity on the same terms as they applied to their own transmission.¹²²

Lastly, the Commission, by reinterpreting certain sections of the FPA, expanded their jurisdiction to include both interstate and intrastate transmissions. They did this by imposing an open access requirement not just on wholesale sales but also on retail transmission where the state had voluntarily unbundled generation and transmission.¹²³ The reasoning of the Commission was once

114. *Id.* § 32.

115. Previously under PURPA, the benefits given to nonutility owned generation had to meet specific conditions to qualify as a QF. The independent power producers that did not meet the PURPA requirements did not receive the benefits of the Act. Thus, these power producers had to comply with costly reporting requirements under PUHCA. PUHCA would eventually be repealed under the Energy Policy Act of 2005. See FED. ELECTION REGULATORY COMM’N, ENERGY POLICY ACT OF 2005: FACT SHEET (2006).

116. See *Otter Tail Power Co. v. United States*, 410 U.S. 366, 374-76 (1973) (noting the FPA does not grant the commission the authority to order wheeling).

117. *Peskoe*, *supra* note 30, at 226-27.

118. FERC Order No. 888, 62 Fed. Reg. 12,274-01 (Mar. 14, 1997) (codified at 18 C.F.R. pt. 35).

119. *Id.* at 12,275.

120. *Id.* at 12,276.

121. *Id.* at 12,299.

122. TOMAIN & CUDAHY, *supra* note 85, at 388.

123. See *New York v. FERC*, 535 U.S. 1, 12-13 (2002); FERC Order No. 888, 62 Fed. Reg., at 30,226.

transmission and generation were separated, it had authority to regulate the transmission because the service “involve[d] only . . . ‘transmission in interstate,’” which falls “within the Federal sphere of regulation.”¹²⁴ The Commission noted, however, that States “clearly retain[ed] jurisdiction over the sale of power” for retail transactions.¹²⁵

In *New York v. FERC*, the Supreme Court was asked to consider whether FERC overstepped the FPA’s jurisdictional bounds by implementing Order 888.¹²⁶ The Court upheld the Order, holding that the final rule did “not affect or encroach upon state authority in such traditional areas as the authority over local service issues, including reliability of local service . . . [and] authority over utility generation and resource portfolios.”¹²⁷ Therefore, although the EPAct of 1992 and FERC Order 888 interjected federal jurisdiction into transmission, it left states’ right to regulate decisions of reliability and generation undisturbed.¹²⁸

The last major piece of legislation was the Energy Policy Act of 2005.¹²⁹ This piece of legislation greatly expanded federal jurisdiction, particularly over electric power transmission and the enforcement of reliability standards.¹³⁰ In regard to transmission, the EPAct of 2005 amended the FPA to give FERC “back stop authority” to order intrastate transmission siting in limited circumstances.¹³¹ More importantly for the discussion in this Note, the EPAct of 2005 gave the Commission expansive authority to approve reliability standards for interstate wholesale markets.¹³² Targeting these “bulk power systems,” the EPAct of 2005 gave FERC authority to certify an Electric Reliability Organization that will have authority to develop and enforce FERC approved reliability standards.¹³³ However, in the savings clause of the Act, FERC was once again denied jurisdiction over generation facilities. More importantly, at least for states, the savings clause protected the rights of states to take actions that ensure reliability within their state, so long as the state action was

124. FERC Order No. 888, 62 Fed. Reg. at 12304. The “nature of the national [energy] grid” made federal regulation of intrastate transmission valid. *New York v. FERC*, 535 U.S. at 17; *see also* *FPC v. Fla. Power & Light Co.*, 404 U.S. 453, 463-65 (1972) (upholding federal jurisdiction after finding that the power of the Florida utility “commingled” with power of another utility in another state).

125. FERC Order No. 888, 62 Fed. Reg. at 12,304.

126. 535 U.S. at 4-5.

127. *Id.* at 24.

128. *See id.*

129. Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005) (codified in scattered sections of 42 U.S.C.).

130. *See id.* §§ 1211(b), 1221(b); *Peskoe*, *supra* note 30, at 238-39.

131. *Peskoe*, *supra* note 30, at 238-40.

132. Federal Power Act, 16 U.S.C. § 824o(b)(1) (2006).

133. *Id.* § 824o(c).

not inconsistent with the federal reliability standards approved by FERC.¹³⁴ This means that if a state wants to take actions that bolster its reliability, it can do so, insofar as it improves reliability for the bulk power system or otherwise does not decrease reliability in connected states.

In summary, the electricity industry has greatly evolved since its inception over a hundred years ago. The bright lines dividing federal and state jurisdiction have slowly dissolved to the point where we now have “a crazy quilt of regulatory authorit[y] and jurisdictions.”¹³⁵ It was inconceivable for Congress in the 1930s to perceive our current needs of electricity or envision the interconnectedness of the grid that regulators and market participants must deal with today. However, over the course of legislative progress one thing has remained clear: Congress continues to support a state’s right, responsibility, and obligation to protect the safety and welfare of its citizens by providing reliable electrical service at a reasonable rate. To accomplish this, Congress has limited federal jurisdiction to only controlling wholesale rates and transmission services, while leaving to states the ability to regulate generation services and dictate the composition of generation supply, enabling them to ensure the continued reliability of electric service and the promotion of legitimate state initiatives.

II. A FAILED MARKET? JURISDICTIONAL CONFLICT BETWEEN FEDERAL AND STATE REGULATION

New Jersey has some of the highest retail electricity prices in the nation.¹³⁶ One cause for these high prices is that New Jersey, being the most densely populated state in the United States,¹³⁷ generates relatively little electric energy to meet the demand of its residential, commercial, and industrial sectors.¹³⁸ This lack of in-state generation is causing severe congestion throughout New Jersey’s transmission grid, which in turn contributes to the high retail prices end-users must pay. Moreover, an even greater concern is the reliability problems that result from a lack of generation in a constrained

134. See § 824o(i).

135. PHILLIPS, *supra* note 79, at 662 (quoting Larry J. Wallace, *Regulation of Election Utility Industry – A Neglected Alternative*, 110 PUB. UTIL. FORT. 13 (1982)).

136. See *Rankings: Average Retail Price of Electricity to Residential Sector, October 2012*, EIA.GOV, <http://www.eia.gov/beta/state/rankings/?sid=NJ#/series/31> (last visited Mar. 21, 2013).

137. *Resident Population Data – 2010 Census: Population Density*, U.S. CENSUS BUREAU, <http://www.census.gov/2010census/data/apportionment-dens-text.php> (last visited Mar. 21, 2013).

138. See *Electric Power Monthly, Table 1.6.A Net Generation*, EIA.GOV (Jan. 23, 2013), http://www.eia.gov/electricity/monthly/epm_table_grapher.cfm?t=epmt_1_6_a.

transmission grid. Electricity is a unique and essential element in all modern economies, and although it is often overlooked, it touches every aspect of modern life. Thus, when there is a capacity shortfall that jeopardizes the welfare and safety of a state, the government of that state must be able to respond in order to protect the public interest.

Recognizing the higher costs and reduced reliability facing the state, the New Jersey Legislature passed legislation that requires the Board of Public Utilities (“BPU”) to begin a program to incentivize development of new electric generation. This legislation culminated in Governor Chris Christie signing into law Senate Bill 2381.¹³⁹ Codified as New Jersey Statute § 48:3-98.2, this legislation would create incentives for new generation to be built by requiring state utilities to enter into long-term, ratepayer subsidized capacity contracts with the selected developers.¹⁴⁰ Known as the New Jersey Long-Term Capacity Agreement Pilot Program (“LCAPP”), this legislation would create approximately 2000 megawatts of new generation that is intended to lower prices and improve reliability for New Jersey ratepayers.¹⁴¹

This Part will first introduce energy markets, giving special attention to the capacity market, which is at issue here.¹⁴² It will then explain the specifics of the LCAPP program and how its proponents expect it to incentivize generation.¹⁴³ The Part will end with a discussion of the tremendous resistance against the new law from both independent power providers and New Jersey utilities.¹⁴⁴ These parties attacked the new law on two fronts. First, shortly after the passage of LCAPP, P3 Power Providers Group (“P3”)¹⁴⁵ filed a 277-page complaint with the FERC seeking to protect consumers from what they believe to be long-term negative consequences that could result from uneconomic and discriminatory entry into the federally controlled wholesale electric markets.¹⁴⁶ Second, a subset of

139. S. 2381, 214th Leg., 2d Ann. Sess. (N.J. 2011); Scott DiSavino, *NJ Gov. Christie Signs Bill to Get More Power Plants Built*, REUTERS.COM (Jan. 31, 2011, 5:43 PM), <http://www.reuters.com/article/2011/01/31/us-utilities-newjersey-newplants-idUSTRE70U7YH20110131>.

140. N.J. STAT.ANN. § 48:3-98.3 (West 2012).

141. DiSavino, *supra* note 139.

142. *See infra* Part II.A.

143. *See infra* Part II.B.

144. *See infra* Part II.C-D.

145. P3 Power Providers Group is a coalition of power companies and state utilities including PSEG, Exelon, EgiPower Resources Corp., NextEra Energy, NRG Energy, Calpine Corp., DPL Energy, GenOn Energy, Edison Mission Energy, PPL Corp., IPR-GDF SUEZ, and Essential Power LLC. *About Us*, THE P3 GROUP, <http://www.p3powergroup.com/sitecontent.cfm?page=about> (last visited Mar. 21, 2013).

146. Complaint and Request for Clarification Requesting Fast Track Processing,

these energy providers brought a claim in the District of New Jersey to challenge the constitutionality of the new law.¹⁴⁷ The plaintiffs contend the new law violates both the dormant commerce clause and the Supremacy Clause of the United States Constitution.¹⁴⁸

A. Energy Markets Demystified

PJM Interconnection is the largest of six different Regional Transmission Organizations (“RTOs”) that operate the transmission grid, administer the energy markets, and in some cases perform ancillary services for each of its assigned regional areas.¹⁴⁹ However, most of the controversy surrounding RTOs centers on their management of the energy and capacity markets.¹⁵⁰ The purpose of this section is to provide a brief background to those who have limited knowledge of how these markets operate and to outline the motivation of states to incentivize generation if these markets should fail.

1. Energy Market

The notable distinction between electric energy and other commodity markets is electrical supply must be instantaneously distributed to meet demand or else the entire grid will be jeopardized.¹⁵¹ Thus, the wholesale energy market, which is the biggest market RTOs operate, is comprised of “two separate but inextricably linked markets—the Day-Ahead Market (DAM) and the Real-Time Market (RTM).”¹⁵² The DAM is a financial market that calculates prices for energy over the course of the next day based upon the RTOs’ projected customer demand and the price bids offered

PJM Power Providers v. PJM Interconnection, L.L.C., No. ER11-2875-000 (FERC Feb. 1, 2011) [hereinafter P3 Complaint].

147. Complaint for Declaratory and Injunctive Relief, PPL EnergyPlus, LLC v. Solomon, No. 3:11-cv-00745 (D.N.J. filed Feb. 9, 2011) [hereinafter PPL Complaint].

148. *Id.*

149. AM. PUB. POWER ASS’N, A BRIEF DESCRIPTION OF THE SIX REGIONAL TRANSMISSION ORGANIZATIONS (RTOs) (2012), available at <http://www.publicpower.org/files/PDFs/RTODescriptionFeb2012FS.pdf>; MONITORING ANALYTICS, 2011 QUARTERLY STATE OF THE MARKET REPORT FOR PJM13 (2011), available at http://www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2011/2011q3-som-pjm-sec2.pdf. PJM’s purpose is to act as “a neutral, independent party [that] operates a competitive wholesale electricity market and manages the high-voltage electricity grid to ensure reliability” and efficiency in providing electricity to thirteen states and the District of Columbia. *Who We Are*, PJM, <http://www.pjm.com/about-pjm/who-we-are.aspx> (last visited Mar. 21, 2013).

150. See Peter Cramton & Steven Stoft, *A Capacity Market That Makes Sense*, 18 ELEC. J. 43, 44-45 (2005).

151. See Steven Ferrey, *Power Future*, 15 DUKE ENVTL. L. & POLY F. 261, 267 (2005).

152. See 2011 NEW JERSEY ENERGY MASTER PLAN 20 (2011), available at http://nj.gov/emp/docs/pdf/2011_Final_Energy_Master_Plan.pdf.

by suppliers.¹⁵³ The role of the RTM, also called the spot market,¹⁵⁴ is to correct imbalances resulting from deviations in the expected demand from the DAM.¹⁵⁵ The RTM is held on the day of delivery and only includes bids from suppliers who did not clear the DAM.¹⁵⁶

The central element to the energy market is Locational Marginal Pricing (“LMP”).¹⁵⁷ The LMP is the mechanism used to calculate the price at which energy is bought and sold at various locations within the RTO area.¹⁵⁸ In the PJM region, LMPs are set in sixteen different localities.¹⁵⁹ Of the sixteen, “[f]our of the highest-priced . . . localities are in . . . New Jersey.”¹⁶⁰ The higher prices are partly due to the constrained transmission system, which can only support a limited amount of electricity.¹⁶¹ Proponents of the pricing mechanism claim it will address congestion problems by relaying price signals to developers and highlighting the most congested areas.¹⁶² Thus, the high prices provide the incentive to build additional generation facilities “when and where they are needed most.”¹⁶³

2. Capacity Markets

Capacity is a different electricity product from energy.¹⁶⁴ In short, capacity is the ability of generating plants “to produce electric energy on an instantaneous basis as and when needed.”¹⁶⁵ In most RTOs, utilities and other load-serving entities are required to accumulate sufficient capacity to meet “peak load” plus arrange for a “reserve margin” of capacity to ensure reliability in unforeseen circumstances.¹⁶⁶ The peak load is usually a historical marker of where demand was highest in the past year, and the reserve margin is a predetermined “percentage of the historical peak load.”¹⁶⁷ Thus, capacity works as a buffer for unexpected peaks in demand.

153. GARY J. NEWELL & RANSOM E. TED DAVIS, AM. PUB. POWER ASS’N, UNDERSTANDING ELECTRICITY MARKETS 12 (2006).

154. Cramton & Stoft, *supra* note 150, at 44.

155. NEWELL & DAVIS, *supra* note 153, at 12.

156. 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 20.

157. NEWELL & DAVIS, *supra* note 153, at 10.

158. *Id.*

159. *See* 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 20.

160. *Id.*

161. *See* Borenstein & Bushnell, *supra* note 40, at 51 (“Once a transmission line reaches its capacity, there is effectively no further ability to import.”).

162. *See* NEWELL & DAVIS, *supra* note 153, at 11. *But see* 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 20 (contending that this pricing mechanism has failed to provide effective market signals to incentivize new generation).

163. 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 20.

164. NEWELL & DAVIS, *supra* note 153, at 12.

165. *Id.*; 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 21.

166. NEWELL & DAVIS, *supra* note 153, at 12.

167. *Id.* at 12-13.

The purpose of the capacity market is twofold. First, capacity markets supplement the revenue of inefficient generating plants that only become operational during hours of peak load.¹⁶⁸ In order to meet demand and provide the cheapest electricity possible, grid operators implement a procedure in which the generating plant with the lowest marginal cost will run first. These plants are called “base load” and consist mainly of nuclear and coal fired plants. These energy plants use relatively cheap fuel to produce power, which gives them a lower marginal cost than intermediate and peaking plants. There is then a progression, whereby plants with the lowest marginal cost to the highest marginal cost will gradually be put online until demand and supply are in equilibrium.¹⁶⁹ The most inefficient generators, called “peakers,” are essential to the system to ensure reliability during peak demand; however, this may only occur a few hours per year.¹⁷⁰ Therefore, to ensure the viability of these peaking plants, capacity markets provide a revenue stream in addition to the plants’ energy sales to ensure these resources are available when needed.¹⁷¹

Second, RTOs with capacity markets require utilities to secure capacity commitments “several years in advance.”¹⁷² This “forward commitment requirement” is intended to ensure there is adequate time to build additional generation.¹⁷³ The RPM in the PJM region uses locational marginal pricing (“LMP”), just like in the DAM and the RTM,¹⁷⁴ in order to provide “better information about whether enough generating capacity is being built” to meet the location’s electric demand.¹⁷⁵ The theory behind the LMP dictates that market price signals in each “capacity zone” will “result in new resources where and when they are needed most.”¹⁷⁶

Under the RPM, auctions for capacity are held each year, with the biggest, the Base Residual Auction, held each May—three years

168. See Cramton & Stoft, *supra* note 150, at 44.

169. FRED BOSSELMAN ET AL., ENERGY, ECONOMICS AND THE ENVIRONMENT 580 (2010).

170. 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 21.

171. *Id.*

172. NEWELL & DAVIS, *supra* note 153, at 13.

173. *Id.* at 12-13.

174. 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 20.

175. NEWELL & DAVIS, *supra* note 153, at 13.

176. 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 20. New Jersey contends that this pricing mechanism has failed and therefore wants to incentivize generation using a traditional state policy. See N.J. STAT. ANN. § 48:3-98.2 (West 2012) (“To address the lack of incentives under the reliability pricing model, the construction of new, efficient generation must be fostered by State policy that ensures sufficient generation is available to the region . . .”). For additional discussion, see NEWELL & DAVIS, *supra* note 153, at 17-20.

prior to the Delivery Year.¹⁷⁷ “In this way, PJM hopes that the forces of supply and demand will attract the capacity necessary to meet future resource adequacy requirements, while its real-time and day-ahead markets take care of current energy needs.”¹⁷⁸ Capacity prices are set in an intricate way. First, demand is administratively set to procure enough capacity to maintain reliability based upon the load forecast for each location. Next, the supply curve is set competitively by obtaining bids from generators, which creates an upward sloping supply curve. At the intersection of the demand and supply curve is the capacity “clearing price.”¹⁷⁹ This is the price given to any generator whose bid was at or below the clearing price, regardless of what their actual bid might have been.¹⁸⁰

FERC is mandated to ensure just and reasonable rates on the wholesale market.¹⁸¹ In order to accomplish this goal, FERC has progressively relied on competitive markets to set rates.¹⁸² However, a condition of using competitive markets is that there must not be any market power possessed by any one firm—that is, the ability of one firm to monopolize control and affect rates.¹⁸³ To limit market power, FERC approved the Minimum Offer Price Rule (“MOPR”)—a pricing rule used to mitigate any uneconomic bid.¹⁸⁴ Thus, if a firm tried to use its market power, either buyer-side¹⁸⁵ or supplier-side,¹⁸⁶ to bid into the RPM, its uneconomic bid would be discovered by the MOPR and would then be administratively set to a percentage of net cost of new entry (“netCONE”).

Therefore, the use of capacity markets is somewhat controversial, or at least its promise to incentivize generation is contested. Nonetheless, these markets seem necessary to secure capacity to meet future demand.¹⁸⁷ This does not mean, however, that states should idly sit by while reliability and congestion get

177. 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 21.

178. Michael T. Burr, *Capacity Contests; Raising the Stakes in RTO Markets*, PUB. UTIL. FORT., Feb. 2011, at 24, 27.

179. 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 20.

180. *See id.* at 40.

181. Federal Power Act, 16 U.S.C. § 824(a) (2006).

182. *See, e.g.*, Dartmouth Power Assoc. Ltd. P’ship, 53 FERC 61,117, 61,360 (1990) (finding market based rates fall “within the legally mandated zone of reasonableness”).

183. *See id.* at 61,359 (setting out specific criteria to determine market power).

184. PJM Interconnection LLC, 117 FERC 61,331, 62,671 (2006).

185. Buyer-side market power is the idea that a net-buyer of energy will sell a small amount of capacity into the market in the hopes of bringing down the overall market price, thereby saving it millions of dollars when they purchase their load requirements.

186. For a discussion of supplier-side market power, see Borenstein & Bushnell, *supra* note 40.

187. *See generally* Cramton & Stoft, *supra* note 150 (arguing that capacity markets are necessary in most restructured energy markets).

worse. Although states have almost no power to influence the design of these federally controlled markets (besides the possibility to leave them), they do have the right to protect the public welfare and safety of their citizens. In cases of market failure, states should legally be able to use this authority to promote new generation.

B. New Jersey's LCAPP

Proponents of New Jersey's new initiative, LCAPP, claim that the program will eventually reduce energy prices and increase reliability for New Jersey consumers. However, critics contend that it will only increase prices because New Jersey ratepayers will be the ones subsidizing the new generation plants, and secondly, it would in fact discourage new generation to be built because it will create uncertainty in the market, which, they claim, is an even greater deterrent than high development costs.¹⁸⁸ This section will explain the mechanisms behind LCAPP and how it is supposed to drive down energy prices.

1. The Mechanics of LCAPP

In the last year, “congestion prices on the PJM Interconnection . . . [have] doubled to \$1.43 billion.”¹⁸⁹ In locations like New Jersey, Delaware, and Maryland, capacity clearing prices in the RPM were ten to fifteen times higher than they were in the Western PJM market.¹⁹⁰ Although this is partly due to increased demand and higher population density in the eastern states, the high price is also attributable to lack of new generating capacity, which has not “been built in [New] Jersey or Maryland for several years.”¹⁹¹

The idea behind LCAPP is to create an incentive for developers to build new generation where the need is greatest—in New Jersey.¹⁹² In theory, the RPM is supposed to do this by providing price signals to potential generation developers that reflect where

188. See *infra* Part II.B.2.

189. Tom Johnson, *Federal Agency Pulls Plug on New Power Plants for NJ*, NJ SPOTLIGHT (April 14, 2011), <http://www.njspotlight.com/stories/11/0414/0005/>.

190. Michael T. Burr, *Parochial Power Play: Northeastern Politicians Declare War on Capacity Auctions*, PUB. UTIL. FORT., Feb. 2011, at 4, 6.

191. See *id.*

192. See N.J. STAT. ANN. § 48:3-98.2 (West 2012) (“To address the lack of incentives under the reliability pricing model, the construction of new, efficient generation must be fostered by State policy that ensures sufficient generation is available to the region, and thus the users in the State in a timely and orderly manner . . .”). *But see* PPL Complaint, *supra* note 147, at 34 (“Witnesses at the November 15, 2010 Senate Environment and Energy Committee Hearing on the Act testified that the Act was ‘essentially a jobs bill . . .’” (quoting *New Jersey Senate Envtl. & Energy Comm. Hearing* (Nov. 15, 2010) (testimony of James B. Kehoe, President, New Jersey State Association of Pipe Trades))).

new generation is needed most.¹⁹³ When the price for capacity rises above the net cost of new entry (“netCONE”), developers have an incentive to build new generation plants or upgrade current facilities.¹⁹⁴ When the price for capacity falls below the netCONE, owners of generating facilities have an incentive to close inefficient plants.¹⁹⁵ In addition to the netCONE values, the RPM uses “locational marginal pricing,” which takes into account locational differences, usually caused by abnormally high demand or a constricted transmission system.¹⁹⁶ These locational differences give further price signals by not only relying on netCONE values but also by taking into account the areas where new generation is needed most.¹⁹⁷ However, New Jersey’s legislature and its BPU think that the RPM has failed.¹⁹⁸ Thus, LCAPP was intended to fill the perceived gap and give developers the incentive needed to start construction.

LCAPP works by directing the BPU to select a limited number of generator developers for the pilot program.¹⁹⁹ The selection of these new generating plants would be done through a bidding process where interested developers would submit the details of the proposed plants and the BPU would then select from the qualified “eligible generators.”²⁰⁰ An eligible generator is essentially a developer of a generation facility that will qualify as “a capacity resource under PJM criteria” and that will commence construction after the passage of the Act.²⁰¹ However, a developer must meet several other factors to be selected as a participant in LCAPP. First, eligible generators must go through a vetting process, which will ascertain the “environmental, economic, and community benefits” that the plants will create.²⁰² The developer must also demonstrate a “reasonable certainty of completion of development, construction and permitting activities necessary to meet the desired in-service date.”²⁰³ From these prequalified generators the board then determines the winners based upon “the net benefit to ratepayers of each prequalified eligible

193. See *supra* Part II.A.1.

194. See 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 21.

195. See *id.*

196. NEWELL & DAVIS, *supra* note 153, at 6-7.

197. 2011 NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 21.

198. See *id.* at 21-22.

199. LEVITAN & ASSOCIATES, INC., LCAPP AGENT’S REPORT: LONG-TERM CAPACITY AGREEMENT PILOT PROGRAM 1-2 (2011).

200. *Id.*

201. N.J. STAT. ANN. § 48:3-51 (West 2012) (An “eligible generator” means a developer of a base load or mid-merit electric power generation facility including, but not limited to, an on-site generation facility that qualifies as a capacity resource under PJM criteria and that commences construction after the effective date of [the Act].”).

202. N.J. STAT. ANN. § 48:3-98.3(b)(2) (West 2012).

203. *Id.*

generator's offer price and term.”²⁰⁴

Once the selection process is over, the BPU requires New Jersey utilities and the participating generators to enter into irrevocable, long-term contracts.²⁰⁵ These contracts, or standard offer capacity agreements (“SOCA”), require the state utilities to provide a guaranteed, fixed price for electric capacity to the state-selected electric generation companies.²⁰⁶ In return, the generators are required to sell their capacity into the PJM capacity market.²⁰⁷

The SOCAs serve two purposes. First, they guarantee a stream of revenue for fifteen years.²⁰⁸ This allows the developers to gather investment capital to build the plants by insuring investors guaranteed revenue. Second, they insulate the selected generators from losses in the capacity market. Under the SOCA, New Jersey's utilities are required to procure 2000 megawatts of capacity from the winning bidders²⁰⁹ at a fixed price that the BPU approves.²¹⁰ This price is guaranteed regardless of the market-clearing price set by the RPM. This means that generators can bid their excess capacity at \$0 per kW, ensuring they clear the RPM clearing price. Once the clearing price is set, the SOCA guarantees the generators will receive the fixed price stated in the SOCA.²¹¹ To clarify, if the clearing price is below the fixed SOCA price, the utilities are required to make payments equal to the difference between the SOCA price and the auction-clearing price multiplied by the generators' SOCA capacity.²¹² On the other hand, if the clearing price is above the fixed SOCA price, the generator must refund the excess to the utility.²¹³ Lastly, the utilities recoup losses associated with their guarantee of the capacity price through a “non-bypassable, irrevocable charge” assessed on ratepayers.²¹⁴

2. Will It Work?

Supporters of LCAPP claim new electric generating facilities, like those selected,²¹⁵ would not be constructed in the absence of the

204. *Id.* § 48:3-98.3(b)(3).

205. *Id.* §§ 48:3-98.3(c)(3), (c)(10).

206. *Id.* § 48:3-98.3(c)(2).

207. *Id.* § 48:3-98.3(c)(11).

208. *See* LEVITAN & ASSOCIATES, INC., *supra* note 199, at 8.

209. N.J. STAT. ANN. § 48:3-98.3(c)(1) (West 2012).

210. *Id.* § 48:3-51 (defining the “standard offer capacity price”).

211. *Id.* (discussing “standard offer capacity price”).

212. *Id.* § 48:3-98.3(c)(4).

213. *Id.*

214. *Id.* § 48:3-98.3(d).

215. LEVITAN & ASSOCIATES, INC., *supra* note 199, at 2. The plants selected for the LCAPP program would be: a 660.1 MW facility at Old Bridge to be built by New Jersey Power Development LLC; a 663.4 MW plant near Woodbridge to be built by CPV Shore

incentives found in LCAPP.²¹⁶ Furthermore, they claim that injection of the new generation into the capacity market will lower market prices more than the cost the ratepayer would have to pay for the subsidies.²¹⁷ In basic economic terms, the increase in supply will cause the net price for energy, even after the increase for the subsidies, to go down. Advocates also point to the relative environmental benefits of burning natural gas, which emits less greenhouse gases than coal or other forms of “dirty” energy.²¹⁸ Lastly, the benefits of new plants include new construction and operations jobs in local communities surrounding each plant.²¹⁹

However, critics claim that LCAPP is simply a “new energy tax” placed on ratepayers that will have little to no effect on decreasing current prices.²²⁰ They claim that the PJM capacity market, known as RPM, is working as intended, but New Jersey has not been patient enough for it to run its course or, alternatively, has not been happy with its results.²²¹ Furthermore, critics contend the Act “would affect the investment decisions of current owners of capacity and potential investors in capacity both in New Jersey and in areas outside of New Jersey.”²²² This, they argue, will result in “less investment in new and existing capacity, in the form of generation sources or demand response.”²²³ Lastly, the effect of the subsidies may create a “slippery slope” whereby future investors will demand similar subsidies for building needed generation in New Jersey, and this reaction could spread to other states that participate in PJM’s capacity market.²²⁴

In conclusion, the effects of LCAPP are still contested and unknown, and perhaps this will remain so if the current litigation

LLC; and a 625 MW plant near Newark to be built by Hess Newark LLC. *Id.* These plants would become operational between 2015 and 2017. *Id.*

216. See generally Tom Johnson, *supra* note 189 (proponents describe how the breaking up of traditional electric monopolies did not have the desired effect of new power plant development).

217. Tom Johnson, *Controversial Ratepayer-Subsidy Bill Passes Both Houses*, NJ SPOTLIGHT (Jan. 11, 2011), <http://www.njspotlight.com/stories/11/0110/2237/>.

218. John Hurdle, *To Build or Not to Build, New Jersey Asks*, AOL ENERGY (July 11, 2011), <http://energy.aol.com/2011/07/11/to-build-or-not-to-build-new-jersey-asks/>.

219. *Id.* (It is “estimated that the new plants would create 2,400 construction jobs over three years, and about 80 full-time equivalent jobs when they become operational.”)

220. See Johnson, *supra* note 217.

221. See Burr, *supra* note 190, at 4-6 (“But have the markets really failed? Are capacity auctions broken? Or are they just sending accurate price signals—albeit sometimes painful ones—based on locational constraints?”).

222. MONITORING ANALYTICS, IMPACT OF NEW JERSEY ASSEMBLY BILL 3442 ON THE PJM CAPACITY MARKET 1 (2011); PPL Complaint, *supra* note 147, at 23.

223. MONITORING ANALYTICS, *supra* note 222; PPL Complaint, *supra* note 147, at 23.

224. MONITORING ANALYTICS, *supra* note 222; see also PPL Complaint, *supra* note 147, at 23.; Johnson, *supra* note 217.

against it either strikes it down as unconstitutional or nullifies it through regulatory rule changes. The importance of using LCAPP in this Note is not determining whether it will work, but rather, to illustrate the broader constitutional and policy arguments behind states' ability to provide reliable and reasonably priced electricity in order to ensure the safety and welfare of its citizens.

*C. LCAPP Resistance—FERC Proceedings*²²⁵

1. P3 Power Providers Group Complaint

As mentioned above, the RPM contains a minimum offer price rule (“MOPR”), which is designed to prevent market manipulation by giving PJM the power to mitigate a bid if it is uneconomically low.²²⁶ Previously, PJM would only flag a bid as uneconomical if it was less than eighty percent of the net cost of new entry (“netCONE”).²²⁷ Furthermore, PJM only mitigated a bid in “the resource’s first delivery year.”²²⁸ For example, a generator’s bid could fail to clear the capacity market the first year if it submitted an uneconomically low bid because the MOPR would revise it upwards.²²⁹ However, it could then submit the same uneconomically low bid the next year and it would clear.²³⁰

On February 1, 2011, P3 Power Providers Group (“P3”) filed a complaint against PJM Interconnection, L.L.C. (PJM) under § 206 of the Federal Power Act.²³¹ In its complaint before the FERC, P3 argued that New Jersey’s law, along with similar legislation in Maryland,²³² exploited “fatally flawed buyer-market-power mitigation provisions,” allowing selected generators to clear the new generation requirements in a discriminatory and uneconomic manner.²³³ Citing a report from PJM’s market monitor, P3 argues that this would artificially and unjustly depress market prices,

225. This section deals with a complaint filed by P3 Power Providers Group and a MOPR filing made by PJM Interconnection. Although there were motions to consolidate the complaint and the MOPR filing into one proceeding, the Federal Energy Regulatory Commission denied the consolidation. PJM Interconnection, L.L.C., 135 FERC 61,022, 61,089 (2011) [hereinafter April 12 Order]. Nonetheless, the Commission addressed both in its order. *Id.* Therefore, this section will address the complaint and filing en masse because both are so integrally intertwined.

226. *See supra* Part II.A.2.

227. April 12 Order, *supra* note 225, at 61,088.

228. Roger D. Stark & Daniel R. Simon, *Traps for Unwary Project Sponsors—The LCAPP Saga*, 90 ELECTRIC LIGHT & POWER 1, 32 (2012).

229. *Id.*

230. *See id.*

231. P3 Complaint, *supra* note 146 (details in “Notice of Complaint” appended to main document).

232. *Id.* at 4-5.

233. *Id.* at 1.

resulting in incumbent generators incurring losses from “buyer-side” market manipulation of around two billion dollars in the Act’s first year of implementation.²³⁴ P3 claims that this potential new entry would disrupt PJM’s capacity market for many years into the future and New Jersey’s unmitigated “exercise of buyer market power” would eventually “sound the death knell of competitive markets.”²³⁵ Subsequently, on February 11, 2011, PJM responded to the complaint by seeking FERC approval to “update and simplify” the MOPR.²³⁶

2. The FERC Decision

On April 12, 2011, against the protests of the BPU and other interveners,²³⁷ the FERC released its decision agreeing and authorizing PJM to make a majority of its proposed revisions.²³⁸ The accepted revisions can be broken into five separate parts:

1. CONE Values: FERC authorized changes to the cost of new entry for gas-powered turbines to now conform to the already established locational marginal pricing (the generators selected for LCAPP were all gas-powered turbines). Before this decision they had been exempt from this category.²³⁹
2. Conduct Test: As noted above, the level at which PJM flagged uneconomically low bids had been set at eighty percent net CONE. This decision changes that level from eighty to ninety percent for the gas powered turbines, effectively making it easier for PJM to mitigate potentially below-cost bids.²⁴⁰
3. Net-Short Test: The net-short test will also be eliminated. Previously, this test would prevent a “net-buyer,” a bidder who was buying more capacity than it was selling in order to drive down market prices, from being able to bid and drive the clearing price down. This test was removed in order to address a loophole that LCAPP exploited. The New Jersey law allowed the selected generators to bid at \$0-kW making sure they cleared the market; however, these generators were not “net-buyers” and therefore would have been able to avoid mitigation entirely.²⁴¹
4. Impact Test: The impact test was eliminated. Formerly, this test required PJM to show whether a bid would exert an impact on

234. *Id.* at 3-5, 7.

235. *Id.* at 6.

236. PJM Interconnection, L.L.C., 135 FERC 61,022, 61,087 (2011) [hereinafter PJM Filing].

237. For the full list of interveners, see April 12 Order, *supra* note 225, at 61,115-17 (Appendices A & B).

238. April 12 Order, *supra* note 225, at 61,089.

239. *Id.* at 61,093-95.

240. *Id.* at 61,096-97.

241. *Id.* at 61,098-99.

clearing prices before they could mitigate the price.²⁴²

5. Zero-Price Bids: Lastly, the RPM does allow zero-price bids; they just need to be economically based. The last effect the order had was to add wind and solar generation to the list of generating resources that are allowed to submit zero-price bids. Previously, the list included nuclear, coal-fired and integrated gasification combined-cycle generators.²⁴³ However, the question remains whether generators of other renewable resources can submit zero-priced bids.

The cumulative effect of these changes would effectively make LCAPP unworkable. Since the conditions of LCAPP require the selected gas-powered generators to clear the capacity market, these generators were planning to submit \$0-kW bids into the auction, guaranteeing them entry. The effect of these revisions to the MOPR would likely allow PJM to mitigate these bids and would most likely prevent these generators from selling capacity at market. Thus, these generators would not be able to get the guaranteed SOCA price because they would fail to clear the market.²⁴⁴

Lastly, FERC's order may have eliminated low-ball bidding, but it has left open the question of how to reconcile the ability of states to dictate energy policy and federal jurisdiction over wholesale energy rates. States traditionally have had the right to favor certain energy resources or technologies or to dictate how the state and its utilities should develop generation capacity to meet resource adequacy rules or further other state economic goals.²⁴⁵ One way the MOPR incorporated this right was with an exemption to mitigation. Known as the "state mandated exemption," it exempts from mitigation "any planned resource being developed in response to a state regulatory or legislative mandate to resolve a projected capacity shortfall."²⁴⁶

PJM contended that the exemption, as it was written, was unjust and unreasonable because it required PJM to review each bid to determine whether it was being developed to meet a projected capacity shortfall.²⁴⁷ This required PJM to judge the "adequacy of state administrative processes," which, PJM argued, could not be

242. *Id.* at 61,101.

243. *Id.* at 61,106-08.

244. Out of the three selected developers for the LCAPP program, two cleared the May 2012 capacity auction. Tom Johnson, *Payments Proposed at Power-Capacity Auction Impact NJ Ratepayers*, NJ SPOTLIGHT (Oct. 4, 2012), <http://www.njspotlight.com/stories/12/10/03/payments-proposed-at-power-capacity-auction-impact-nj-ratepayers/>; see also LEVITAN & ASSOCIATES, INC., *supra* note 199. The clearing price for the May auction was \$167.46. Johnson, *supra*. Hess and CPV cleared the auction price, while NRG did not. Under their respective SOCAs, Hess will get an additional \$220 per megawatt from ratepayers and CPV will receive an additional \$286.03. *Id.*

245. See *infra* Part III.A.

246. April 12 Order, *supra* note 225, at 61,103.

247. *Id.* at 61,104.

done by RTOs that did not have the necessary manpower or resources.²⁴⁸ In its place, PJM suggested an alternative method whereby state commissions petition FERC for a determination under § 206 of the Federal Power Act before they develop the generation.²⁴⁹ The Commission agreed with PJM's assessment that the original state exemption was unjust and unreasonable and allowed them to eliminate it.²⁵⁰ However, the Commission found that the proposed replacement mechanism was redundant because states already retained the right to petition FERC under § 206, and therefore rejected PJM's replacement proposal.²⁵¹

Consequently, the boundary between FERC regulated wholesale power markets and the constitutional authority of state regulators and legislatures to oversee in-state development of electric generation resources is now convoluted. FERC's order seems to say that states remain legally and constitutionally free to interfere with RTO capacity markets, at least indirectly, but if they do, FERC will neutralize their efforts by controlling wholesale rates.²⁵² FERC's exact language states:

While the Commission acknowledges the rights of states to pursue legitimate policy interests, and while, as we have said, any state is free to seek an exemption from the MOPR . . . [However, b]ecause below-cost entry suppresses capacity prices . . . we are statutorily mandated to protect the RPM against the effects of such entry.²⁵³

Therefore, FERC has left states apparently still exempt from price mitigation and review under the PJM capacity market, yet FERC is threatening to act if those states should take advantage of their lawful exemption.

On November 17, 2011, the Commission attempted to clarify the "state exception"; however, the order on rehearing raised more questions than it answered.²⁵⁴ First, in response to the BPU's and the Maryland Commission's complaint that FERC disregarded their states' reliability needs, FERC restated that "the MOPR does not interfere with states or localities that, for policy reasons, seek to provide assistance for new capacity entry if they believe such expenditures are appropriate for their state."²⁵⁵ Continuing, the Commission simply stated that if state programs had manipulated

248. *Id.*

249. *Id.* at 61,103.

250. *Id.* at 61,106.

251. *Id.* (stating the ability to petition FERC for a change to a filed rate schedule is a "statutory right" and "not a right created by contract").

252. *See id.*

253. *Id.*

254. PJM Interconnection, L.L.C., 137 FERC 61,145 (2011) [hereinafter November 17 Order] (order on compliance filing, rehearing, and technical conference).

255. *Id.* ¶ 89 (citing with approval April 12 Order, *supra* note 225, at 61,089).

wholesale prices, FERC has a statutory duty to stop the manipulation.²⁵⁶ FERC explained that states have two causes of action that they can use if they find that the RPM is failing to provide sufficient incentives. First, PJM participants could amend the RPM to incorporate a forecast longer than three years to ensure reliability, or it could be amended to provide explicit provisions recognizing technological or environmental goals by state legislatures.²⁵⁷ Second, state commissions retain the right to file a complaint under § 206 for a declaratory order from FERC to determine whether the rate is just and reasonable.²⁵⁸

Additionally, the Commission clarified that the procedural process, by which they found PJM's request to remove the state mandate as just and reasonable, was perfectly compatible with their subsequent order finding PJM's replacement mechanism as unjust and unreasonable.²⁵⁹ FERC saw these as two separate proposals, and PJM did not condition one upon the other. Lastly, FERC admonished the protesting parties stating that "the state exemption created a loophole permitting uneconomic entry affecting the wholesale price."²⁶⁰ The Commission restated that this uneconomic entry may adversely affect other states that were relying on prices in the capacity market to incentivize new generation and who did not want to implement similar state subsidized generation in their own states.²⁶¹

In conclusion, FERC's April 12 Order and subsequent clarification order on November 17 severely limited New Jersey and other states' ability to dictate their own energy policy. Whether it is to favor certain types of resources or provide greater reliability, states' ability to implement these policy objectives without "manipulating" the federal wholesale market remains unclear. Questions that remain unanswered are: (1) what constitutes an impermissible subsidy that requires mitigation; (2) to what extent can a subsidy manipulate the market; and lastly, (3) what is the current role of state government in a federally controlled market?

256. *Id.* ¶ 97.

257. *Id.* ¶ 90.

258. *Id.* ¶ 91.

259. *Id.* ¶¶ 93-95.

260. *Id.* ¶ 96.

261. *Id.* ¶¶ 96-97.

*D. LCAPP Resistance Continued—Is LCAPP Unconstitutional?*²⁶²

In the Federal District Court of New Jersey, eight plaintiffs²⁶³ filed suit against Lee Solomon—in his official capacity as President of the New Jersey Board of Public Utilities (“BPU”)—and Jeanne Fox, Joseph Fiordaliso, and Nicholas Asselta, all in their official capacities as Commissioners of the BPU.²⁶⁴ The plaintiffs sought an injunction against the BPU from enforcing or implementing all but § 5 of LCAPP and declaring the Act unconstitutional for violating the Supremacy and Commerce Clauses of the United States Constitution.²⁶⁵

The plaintiffs contend that LCAPP violates the preemption doctrine, created from a plethora of case law under the Supremacy Clause, because it intrudes on federal jurisdiction to regulate wholesale electricity transactions.²⁶⁶ They argue that the Act’s requirement that selected generators must clear the auction equates to requiring these capacity resources to submit a zero bid offer. Once cleared, the Act guarantees the selected generators a set price, predetermined in the SOCA, for any of their capacity sold in the RPM.²⁶⁷ The plaintiffs contend this behavior usurps FERC’s authority by controlling “a generator’s market behavior, or dictat[ing] a generator’s offer price, in a FERC-regulated wholesale transaction.”²⁶⁸ Furthermore, the plaintiffs argue that LCAPP goes against “FERC’s decision to have capacity prices . . . set by market

262. In addition to the current litigation in the District Court of New Jersey, a similar action is being brought in the District Court of Maryland. *See PPL Energyplus, LLC v. Nazarian*, No. MJG-12-1286 (D. Md. Aug. 3, 2012). The causes of action are identical, with the underlying issue based upon a Maryland Public Service Commission (“PSC”) order to subsidize generation in Maryland. *Id.* at 2-3. The PSC order, for all relevant purposes, is the same as the LCAPP initiative, in that it promises a set price for capacity once the selected generator clears the PJM capacity auction. *Id.* In order to reduce redundancy, only the New Jersey litigation will be discussed in this note.

263. There were eight plaintiffs, each classified as a “Generator Plaintiff” or a “Utility Plaintiff.” The Generator Plaintiffs were Calpine, Exelon, GenOn, NAEA Ocean Peaking Power, and PPL Parties PSEG Power. The Utility Plaintiffs included Atlantic City Electric Company and Public Service Electric and Gas Company—both New Jersey utilities. *See PPL Complaint, supra* note 147, at 2.

264. Neither FERC nor PJM Interconnection joined this action, which the district court found odd. *See PPL EnergyPlus, LLC v. Solomon*, No. 11-745, 2012 WL 4506528 (D.N.J. Sept. 28, 2012).

265. *PPL Complaint, supra* note 147, at 34.

266. At the time this Note was going to publication, Judge Sheridan denied both the plaintiffs’ and defendants’ motions for summary judgment on the preemption claim, holding that there were questions of material fact that needed to be vetted in regards to whether LCAPP constituted “an obstacle” to a federal objective. *See PPL EnergyPlus, LLC*, 2012 WL 4506528, at *6, *9-10.

267. *PPL Complaint, supra* note 147, at 26.

268. *Id.* at 26-27.

forces.”²⁶⁹ Since the passage of PURPA, the federal government has begun to let wholesale rates for generation be set by supply and demand.²⁷⁰ The plaintiffs argue that subsidizing the selected generators would distort the clearing price for capacity, thereby interfering with the federal government’s intended goal.²⁷¹

The plaintiffs’ second argument is that the Act violates the Commerce Clause, specifically what is known as the dormant commerce clause.²⁷² The purpose of this doctrine is to stop states from interfering with interstate commerce or using their regulatory power to favor in-state businesses over out-of-state businesses.²⁷³ The plaintiffs argue that LCAPP violates the dormant commerce clause because “its intent and effect are to discriminate in favor of in-state generation and against out-of-state generation.”²⁷⁴ The plaintiffs contend that the selection process for receiving the subsidies excluded out-of-state generators and, even if that was not the intent, it was the practical effect since all three selected generators are to be built in New Jersey.²⁷⁵ Further, the generators’ bids into the capacity market will have the effect of increasing New Jersey’s total percentage share of the capacity market while decreasing the market share of generators from other states in the regional market.²⁷⁶

III. A CONSTITUTIONAL CHALLENGE FOR FEDERALISM AND THE POLICY BEHIND A STATE’S RIGHT TO RELIABLE ENERGY

State regulation of utilities has traditionally been a function of local police power.²⁷⁷ However, because of the expanding interconnectedness of regional grids, any state wishing to implement a mechanism to incentivize generation will likely impact one or more neighboring states. The two biggest constitutional concerns deriving from state regulation designed to create incentives for generation are the preemption doctrine, created from a progeny of case law under the Supremacy Clause and the dormant commerce clause, also known as the negative commerce clause.²⁷⁸ Generally, if Congress has passed a law within their lawful exercise of power, the analysis

269. *Id.* at 27.

270. *See, e.g.*, Dartmouth Power Assoc. Ltd., 53 FERC 61,117, 61,360 (1990) (discussing the applicability of market rates provided that company in question does not have “market power”).

271. PPL Complaint, *supra* note 147, at 27.

272. *Id.* at 31.

273. *See infra* Part III.B.

274. PPL Complaint, *supra* note 147, at 31.

275. *Id.* at 31-32; *see also* LEVITAN & ASSOCIATES, INC., *supra* note 199, at 2.

276. PPL Complaint, *supra* note 147, at 31-32.

277. Ark. Elec. Coop. v. Ark. Pub. Serv. Comm’n, 461 U.S. 375, 377 (1983) (citing *Munn v. Illinois*, 94 U.S. 113 (1877)).

278. *See infra* Part III.A-B.

under the preemption doctrine will focus on whether the federal law or regulation preempts state law. If a court finds no preemption, the state law may still be struck down if the court determines that it places an “undue burden” on interstate commerce.²⁷⁹

Subparts A and B will examine both constitutional issues and the effect they could have on New Jersey’s LCAPP and future state initiatives to subsidize generation. Subpart C will conclude with a policy argument, contending that states must have the right to unilaterally encourage generation, especially if there is a capacity shortfall that could endanger the safety and welfare of the state.

A. *The Preemption Doctrine*

Article VI of the Constitution provides that the Constitution and all laws made pursuant to it or laws made “under the Authority of the United States,” are “the supreme law of the Land.”²⁸⁰ The preemption doctrine developed under this clause and demands any state law that is in conflict with a federal law be struck down as impermissible.²⁸¹ In 1988, Justice Blackmun clearly articulated the doctrine as follows:

The circumstances in which federal law pre-empts state regulation are familiar. A pre-emption question requires an examination of congressional intent. Of course, Congress explicitly may define the extent to which its enactments pre-empt state law. In the absence of explicit statutory language, however, Congress implicitly may indicate an intent to occupy a given field to the exclusion of state law. Such a purpose properly may be inferred where the pervasiveness of the federal regulation precludes supplementation by the States, where the federal interest in the field is sufficiently dominant, or where “the object sought to be obtained by the federal law and the character of obligations imposed by it . . . reveal the same purpose.” *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Finally, even where Congress has not entirely displaced state regulation in a particular field, state law is pre-empted when it actually conflicts with federal law. Such a conflict will be found “when it is impossible to comply with both state and federal law, *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-143 (1963), or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress, *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).”²⁸²

279. See *infra* Part III.A-B.

280. U.S. CONST. art. VI, cl. 2.

281. *Gade v. Nat’l Solid Wastes Mgmt. Ass’n*, 505 U.S. 88, 108 (1992) (“[U]nder the Supremacy Clause, from which our pre-emption doctrine is derived, ‘any state law, however clearly within a State’s acknowledged power, which interferes with or is contrary to federal law, must yield.’” (quoting *Felder v. Casey*, 487 U.S. 131, 138 (1988)); *Gibbons v. Ogden*, 22 U.S. (9 Wheat) 1 (1824).

282. *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 299-300 (1988) (some citations

The difficulty with the preemption clause is determining when there is a conflict.²⁸³ Preemption has traditionally occurred when 1) Congress has expressly preempted state law, or 2) a federal statute or regulation implicitly commands state law to yield because of its “structure and purpose.”²⁸⁴ In regards to a state implementing a law to subsidize generation, preemption challenges will most likely contend that federal law implicitly preempts state law.²⁸⁵ There are two types of implied preemption: (1) if there is a clear congressional intent that federal law should exclusively occupy the field (field preemption); and (2) if there is a conflict between federal and state law (conflict preemption).²⁸⁶ Conflict preemption can be broken down further: courts have found preemption “where compliance with both federal and state regulations is a physical impossibility”²⁸⁷ or where state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”²⁸⁸

Consequently, as with the case of the LCAPP litigation in federal court,²⁸⁹ challengers to the state subsidies will most likely argue that federal law either commands the “field” of regulation or, alternatively, that state law impedes the achievement of a federal objective. In either case, the determinative statute is the Federal Power Act.²⁹⁰ Thus, any constitutional analysis under the preemption doctrine must start by determining what the congressional intent or goal was for enacting that piece of legislation.²⁹¹ This section will argue that Congress has expressly and implicitly preserved traditional state police powers, including the ability to dictate in-

omitted).

283. See ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 437-40 (Erwin Chemerinsky et al. eds., 3d ed. 2006).

284. *Gade*, 505 U.S. at 98 (holding “[p]re-emption may be either express or implied”); see also *Hillsborough Cnty. v. Automated Med. Lab., Inc.*, 471 U.S. 707, 713 (1985) (finding “state laws can be pre-empted by federal regulations as well as by federal statutes”).

285. See, e.g., *Fla. Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

286. *Gade*, 505 U.S. at 98.

287. *Fla. Lime & Avocado Growers, Inc.*, 373 U.S. at 142-43.

288. *Hines*, 312 U.S. at 67.

289. See *PPL EnergyPlus, LLC v. Solomon*, No. 11-745, 2012 WL 4506528 (D.N.J. Sept. 28, 2012).

290. FERC was created under the Federal Power Act, thus any determination of preemption must start with an analysis of the authority given to the Commission by Congress and the congressional intent of regulating interstate energy. See Federal Power Act, 16 U.S.C. §§ 791-823 (2006).

291. *Gade*, 505 U.S. at 96 (“[T]he question whether a certain state action is pre-empted by federal law is one of congressional intent.” (quoting *Allis-Chalmers Corp. v. Lueck*, 471 U.S. 202, 208 (1985))); *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 484 (1996) (“[T]he purpose of Congress is the ultimate touchstone’ in every pre-emption case.” (quoting *Retail Clerks Int’l Ass’n v. Schermerhorn*, 375 U.S. 96, 103 (1963))).

state generation and to provide sufficient energy to meet the needs of state residents, in order for states to ensure the safety and welfare of their citizens. Therefore, a challenge to state subsidies under the preemption doctrine should fail.

Under “field pre-emption,” the Supreme Court has said that where the scheme of federal law implies a clear intent that federal law should exclusively occupy the field, state law must necessarily be preempted.²⁹² However, absent an express preemption provision, courts generally apply a strong presumption that the state law is constitutional.²⁹³ In cases where preemption concerns regulations as opposed to statutes, the Court has been even more reluctant to find preemption of a field.²⁹⁴ Through the development of case law under the Supremacy Clause, the courts have outlined various factors that provide guidance in its analysis of field preemption. The first is whether the state regulation is in an area traditionally dominated by federal authority.²⁹⁵ The second factor is whether Congress has expressed an intent for federal law to be “exclusive” in the area of regulation.²⁹⁶ The congressional intent can be drawn from the text of the federal law or the legislative history. The third criterion is

292. *Gade*, 505 U.S. at 96; *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947) (determining that intent may be found when federal regulation is “so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it”); *Barnett Bank of Marion Cnty., N.A. v. Nelson*, 517 U.S. 25, 31 (1996) (determining federal occupation of an entire field “reveal[s] a clear, but implicit, pre-emptive intent”).

293. *Wyeth v. Levine*, 555 U.S. 555, 565 (2009) (finding “‘in a field which the States have traditionally occupied,’ . . . we ‘start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress’” (quoting *Medtronic*, 518 U.S. at 485)); *Medtronic*, 518 U.S. at 485 (“[B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action.”); see also Mary J. Davis, *The “New” Presumption Against Preemption*, 61 HASTINGS L.J. 1217, 1223, 1228-33 (2010) (finding that in recent court opinions there is still a presumption against preemption).

294. *Hillsborough Cnty. v. Automated Med. Lab., Inc.*, 471 U.S. 707, 717 (1985) (“We are even more reluctant to infer pre-emption from the comprehensiveness of regulations than from the comprehensiveness of statutes. As a result of their specialized functions, agencies normally deal with problems in far more detail than does Congress. To infer pre-emption whenever an agency deals with a problem comprehensively is virtually tantamount to saying that whenever a federal agency decides to step into a field, its regulations will be exclusive. Such a rule, of course, would be inconsistent with the federal-state balance embodied in our Supremacy Clause jurisprudence.”); see also *New York v. FERC*, 535 U.S. 1, 18 (2002) (holding “‘that a federal agency may pre-empt state law only when and if it is acting within the scope of its congressionally delegated authority[.] . . . [for] an agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it.’” (quoting *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986))).

295. CHEMERINSKY, *supra* note 283, at 408.

296. *Id.*

whether the state law or regulation serves a traditional state interest. Lastly, courts look to whether the state law would interfere with comprehensive federal authority. Each of these factors will be taken in turn; however, none are dispositive to a court's ruling.²⁹⁷

In regard to the first factor, grants of federal authority over the electric industry are found exclusively in the FPA. The Act gives the FERC federal authority over "matters relating to . . . the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce."²⁹⁸ However, the Act explicitly declares that federal jurisdiction shall not extend to regulation "over facilities used for the generation of electric energy or over facilities used in local distribution."²⁹⁹ The Supreme Court recognized this distinction and inferred the intent of the statute was "not to impair or diminish the powers of any State commission."³⁰⁰ Thus, the traditional area of federal authority lies only in the transmission in interstate commerce and pricing of wholesale electricity but does not include areas such as state regulation of energy planning, which includes providing sufficient generation to meet the needs of the state.

The second factor requires a determination that Congress intended federal law to be exclusive in the field of regulation. Congress has never stated that they wished to be the exclusive regulator in the electricity industry. The FPA states that federal regulation is "to extend only to those matters which are not subject to regulation by the States."³⁰¹ Subsequently, when Congress amended the FPA with the implementation of PURPA, the expansion of federal jurisdiction was determined to still be coextensive with a state's ability to regulate in the field. Although the Supreme Court determined that Congress *could* preempt a state's ability to completely regulate private utilities, it chose not to.³⁰² Instead, the Court determined that Congress intended PURPA to show "deference to state authority"³⁰³ and to establish "a program of cooperative federalism that allows the States . . . to enact and administer their own regulatory programs, structured to meet their own particular needs."³⁰⁴

This intention carried into the reconstruction era. Starting from the EAct of 1992 to the EAct of 2005, Congress has continued to

297. *Id.*

298. Federal Power Act, 16 U.S.C. § 824 (2006).

299. *Id.*

300. Conn. Light & Power Co. v. FPC, 324 U.S. 515, 525-27 (1945).

301. 16 U.S.C. § 824(a).

302. FERC v. Mississippi, 456 U.S. 742, 758-70 (1982).

303. *Id.* at 765.

304. *Id.* at 767 (quoting *Hodel v. Va. Surface Mining & Reclamation Ass'n, Inc.*, 452 U.S. 264, 289 (1981)).

respect a state's power to regulate generation and retail rates.³⁰⁵ In determining the constitutionality of FERC Order 888, the Supreme Court made clear that the legislative history of the FPA was "replete with statements describing Congress' intent to preserve state jurisdiction over local facilities."³⁰⁶ In upholding the constitutionality of the order, the Court found the promulgated rule did "not affect or encroach upon state . . . issues, including . . . authority over utility generation and resource portfolios."³⁰⁷ Then in 2005, with the passage of the new EPAct, Congress extended federal jurisdiction again—this time granting FERC the power to approve reliability standards for bulk power systems.³⁰⁸ However, once again Congress expressly acknowledged the traditional powers of states by inserting a savings clause into the FPA that states that federal law did not preempt "any State [from taking] action to ensure the safety, adequacy, and reliability of electric service within that State."³⁰⁹ Additionally, it restricted FERC from requiring construction of additional generation capacity or to "set and enforce . . . standards for adequacy or safety of electric facilities."³¹⁰ Thus, from the enactment of the FPA to its recent amendments by the EPAct of 2005, Congress has explicitly reserved a sphere of regulation that states can control, which is coextensive with federal regulation. If Congress wanted to eliminate dual state and federal regulation, they could have done so; instead, they have demonstrated that state regulation is important by employing the idea of cooperative federalism.³¹¹

The third criterion courts consider is whether the state law encompasses a traditional state interest.³¹² In New Jersey, the state legislature has delegated the BPU authority over

305. See *supra* notes 112-134 and accompanying text.

306. *New York v. FERC*, 535 U.S. 1, 22 (2002).

307. *Id.* at 24 (quoting FERC Order No. 888, 62 Fed. Reg. 12,274, 31,782 n.544 (Mar. 14, 1997) (codified at 18 C.F.R. pt. 35)).

308. Federal Power Act, 16 U.S.C. § 824o (2006).

309. § 824o(i)(3).

310. § 824o(i)(2).

311. *FERC v. Mississippi*, 456 U.S. 742, 765-67 (1982); see also Adam Babich, *The Supremacy Clause, Cooperative Federalism, and the Full Federal Regulatory Purpose*, 64 ADMIN. L. REV. 1, 22-23 (2012) (finding "theories of cooperative federalism recognize that federal and state powers and responsibilities overlap and interact"); cf. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 240 (1947) (holding state law was preempted because the purpose of the federal law was to eliminate dual state and federal regulation).

312. Where the field of regulation is one that the states have traditionally regulated, the Court has stated that the presumption is against preemption, and the Court starts "with the assumption that the historic police powers of the States were not to be superseded . . . unless that was the clear and manifest purpose of Congress." *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 206 (1983) (quoting *Rice*, 331 U.S. at 230).

all services necessary for the transmission and distribution of electricity . . . including but not limited to safety, reliability . . . shall remain the jurisdiction of the Board of Public Utilities. The board shall also maintain the necessary jurisdiction with regard to the production of electricity . . . to assure the reliability of electricity . . . to retail customers in the State.³¹³

The New Jersey statute is typical of those found in states that have a public utility commission or similar state regulatory agency.³¹⁴ The duty of providing for the safety and welfare of state citizens is tantamount to state sovereignty. Thus, if federal energy markets fail to provide sufficient electric energy to meet state demand, to the point of causing instability in the grid, then a state initiative to create new generation would go to the heart of providing for the public welfare. And according to the BPU and the New Jersey legislature, this is the stated reason for enacting LCAPP. At the BPU hearing in 2007, New Jersey's reliability concerns were even supported by statements of PJM officials, during which PJM indicated the possibility of brownouts or blackouts was likely in the New Jersey region.³¹⁵ Although PJM, with FERC's support, has since retracted those statements, the BPU's position has not changed.³¹⁶

Lastly, courts look to the potential risk of interference in federal regulatory efforts if the court should allow the state regulations to stand. This is closely tied to the other type of implicit preemption—conflict preemption—and asserts that if a state law impedes the achievement of federal objectives then the state law must be struck down. The potential for creating an obstacle to the federal scheme can be a key factor in determining preemption.³¹⁷ Since this last factor calls for a similar analysis to conflict preemption, both will be merged into the analysis below.

The second challenge that states will have to overcome is a contention that the state law interferes with a federal objective.

313. N.J. STAT. ANN. § 48:2-13(d) (West 2012). Furthermore, the New Jersey legislature declared that the BPU should “foster the production and delivery of electricity . . . in such a manner as to lower costs and rates and improve the quality and choices of service for all of the State's consumers.” *Id.* § 48:2-21.24.

314. *See, e.g.*, N.Y. ENERGY LAW § 6-102(5) (McKinney 2011) (directing the State Energy Planning Board to be guided by “improving the reliability of the state's energy systems; insulating consumers from volatility in market prices [and] reducing the overall cost of energy in the state”).

315. PPL EnergyPlus v. Solomon, No. 11-745, 2012 WL 4506528 (D.N.J. Sept. 28, 2012).

316. *Id.*

317. *See generally* City of Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624 (1973). A state law that attempted to limit the timing and takeoffs at airports due to noise concerns was preempted because the Court found that the scheme of federal regulation would be impaired. *Id.* at 625-26. The Court feared that if every municipality created their own regulations then the Federal Aviation Administration could not effectively regulate the airspace. *Id.* at 639.

Preemption will exist if state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”³¹⁸ What constitutes “a sufficient obstacle is a matter of judgment, to be informed by examining the federal statute as a whole and identifying its purpose and intended effects.”³¹⁹ The court’s determination of conflict preemption rests on its characterization of the federal goal and the purpose of the state law. This is a two-step analysis and, depending upon the court’s level of abstraction, can either lead to the state law being upheld or struck down.

The first factor in predicting whether a court will find a state law preempted is how broad or narrow the court characterizes the federal objective.³²⁰ However, the inconsistency of case law makes predicting the level of abstraction the court will use in determining federal goals difficult.³²¹ Nonetheless, courts generally start by interpreting the text of the federal statute or regulation and the legislative or regulatory intent for passing them.³²² The second part of the analysis rests on the characterization of the state law and its purpose. Depending on how the court construes the state law, it could find that the purported purpose of the law creates an obstacle to the federal objective.

This analysis was illustrated in the Court’s opinion in *Pacific Gas & Electric Co. v. State Energy Resources Conservation &*

318. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941); *see also* *Wyeth v. Levine*, 555 U.S. 555, 573-74 (2009) (noting that preemption does not exist as a defense where the congressional purpose was to strengthen state law remedies).

319. *Crosby v. Nat’l Foreign Trade Council*, 530 U.S. 363, 373 (2000).

320. *See id.* at 373-75; *see also* *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm’n*, 461 U.S. 190, 206-09 (1983) (construing the federal law narrowly).

321. *See* CHEMERINSKY, *supra* note 283, at 413-16.

322. *See, e.g., Wyeth*, 555 U.S. at 573-81 (The Court did not find conflict preemption because Congress was silent on the issue of whether state tort laws would create an obstruction to federal objectives under the Federal Food, Drug, and Cosmetic Act (FDCA). The Court stated that “[i]f Congress thought state-law suits posed an obstacle to its objectives, it surely would have enacted an express pre-emption provision at some point during the FDCA’s 70-year history.”); *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 861-86 (2000) (holding preemption was implied based on the regulatory purposes and history of the National Traffic and Motor Vehicle Safety Act of 1966 and the Department of Transportation’s standards promulgated under that Act); *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 486 (1996) (“Congress’ intent, of course, primarily is discerned from the language of the pre-emption statute and the ‘statutory framework’ surrounding it. Also relevant, however, is the ‘structure and purpose of the statute as a whole,’ as revealed not only in the text, but through the reviewing court’s reasoned understanding of the way in which Congress intended the statute and its surrounding regulatory scheme to affect business, consumers, and the law.” (citations omitted)); *see also* Davis, *supra* note 293, at 1245 (“Implied obstacle preemption . . . requires . . . a rigorous assessment of whether Congress, not just the agency charged with effectuating Congress’s intent, considered state law claims to pose an obstacle to the accomplishment of those objectives.” (citing *Wyeth*, 555 U.S. at 574-76)).

Development Commission.³²³ *Pacific Gas & Electric* concerned a state law that placed a moratorium on the construction of nuclear plants until the State Energy Commission determined that the disposal of the nuclear waste could be safely administered.³²⁴ The utility opposing the California law argued that the law should be struck down because it intruded upon the field that Congress intended to occupy and that it interfered with the federal objective of promoting nuclear energy.³²⁵

In upholding the California state law, the Court made two important findings. First, the Court characterized the federal intent for the Atomic Energy Act (“AEA”) as ensuring safety and promoting nuclear power.³²⁶ However, the Court narrowed the congressional intent by finding that promotion of nuclear power was “not to be accomplished ‘at all costs,’” and the traditional areas of state regulation, such as reliability, need, and cost, would still be the ultimate authority in nuclear siting.³²⁷ If the Court had instead interpreted congressional intent broadly, such that any state law interfering with the promotion of nuclear generation would be preempted, then the decision would have come out the other way. Second, the Court characterized the state’s purpose as economic and not safety related.³²⁸ This was an important distinction because if the Court found the primary purpose of the law was safety related, it would have been found to be an obstruction of the purported purpose of the AEA.³²⁹ Thus, in determining that the California law was not preempted, the Court’s decision hinged on the level of abstraction used in determining the purposes of the federal and state laws.

The application of this analysis to the issue of a state law subsidizing new generation requires a characterization of the federal intent of the FPA and its subsequent amendments and a determination of the purpose behind the state law. One of the primary concerns of Congress has been for wholesale rates to be “just and reasonable.”³³⁰ Beginning with the passage of PURPA, the use of competitive markets has been the method of choice to accomplish this

323. See 461 U.S. at 190-229.

324. *Id.* at 194-95.

325. See *id.* at 204.

326. *Id.* at 221-23.

327. *Id.*

328. *Id.* at 216.

329. *Id.* at 213.

330. Federal Power Act, 16 U.S.C. § 824d (2006) (“All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.”).

goal.³³¹ In moving away from rates based on the cost of service plus a reasonable return, FERC has allowed rates to be determined by competitive markets so long as no single utility has significant market power. Additionally, Congress has promoted the use of competition in electric generation as a way of bringing down wholesale prices. Therefore, any manipulation of the wholesale markets by a state law could be construed as an impediment to this goal and be found unconstitutional.³³²

However, the purpose for “just and reasonable” rates has always been based upon the protection of the public interest.³³³ Thus, a better definition of the congressional intent for federal regulation in the electric industry is to create and promote competitive energy markets only to the extent that it does not adversely cause harm to the public. It follows that if competitive markets are failing to provide the incentives for new generation, and this lack of incentive is causing harm to citizens in a particular state, then the congressional intent for federal regulation would not be obstructed if the state created a law under their traditional power of state energy planning to provide that incentive. Alternatively, even if the federal energy markets are working correctly, the ability of states to regulate the planning and generation of energy to meet the needs of state residents has not been challenged by the courts or the FERC. Thus, if a state wanted to subsidize renewable energy generation, for the purposes of a state environmental policy, for example, then it would be constitutional for them to do so and would not be an obstruction of federal purpose since Congress has expressly reserved this power to the states.³³⁴ The fact that a state subsidy affects the competitive

331. See *supra* Part I.C.

332. See Ferrey, *supra* note 85, at 636 (finding “state techniques that impose above-market pricing for wholesale power transactions cross the boundary of permissible state authority”); see also *PPL Energyplus, LLC v. Solomon*, No. 11-745, 2011 WL 5007972, at *5 (D.N.J. Oct. 20, 2011) (denying defendant’s motion to dismiss and finding the plaintiffs successfully pled that “[LCAPP] impedes the FERC’s policy of establishing a market-based approach to setting wholesale energy rates in the mid-Atlantic market”).

333. 16 U.S.C. § 824(a) (2006) (“[T]he business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and . . . Federal regulation of matters relating to generation to the extent provided [by these laws] and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.”); see, e.g., *Pa. Water & Power Co. v. FPC*, 343 U.S. 414, 418 (1952) (“A major purpose of the whole [FPA] is to protect power consumers against excessive prices.”); *Cal. ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1017 (9th Cir. 2004) (“[P]rotecting consumers” is the FPA’s “primary purpose.”).

334. FERC expressly acknowledged a state’s ability to promulgate regulations favoring particular generation technologies over others, in holding that a “state may

market does not necessarily make it an obstacle to the federal objective.

Consequently, the question that remains is how can a state promote in-state generation without a court finding it unconstitutional based on preemption grounds. The states may have the constitutional ability to provide incentives for new generation; however, the mechanism that they use to accomplish that goal must still not cross into the field of regulating wholesale prices directly. The New Jersey LCAPP law promotes generation by requiring utilities to enter into long-term contracts that guarantee the selected generators a set price for the capacity they sell on the wholesale capacity market.³³⁵ Further, the Act mandates these generators to clear the RPM market before they qualify for the subsidy.³³⁶ The FPA gives exclusive jurisdiction of the wholesale market to FERC.³³⁷ Thus, a court will likely strike down LCAPP if it concludes the subsidy tries to regulate the price set at wholesale market.

Although states cannot directly control the price set at wholesale, they nonetheless have a multitude of state regulatory actions available, such as demand response or energy efficacy, that fall under the ability of states to control the need, economics, feasibility, and retail services that have been the traditional area of state regulation.³³⁸ Clearly, some of these actions will have an effect on prices in the wholesale markets, especially those of demand response, which curtails demand during peak load and would presumably bring down the price at wholesale. However, the difference between these actions and guarantees of a set price in wholesale markets is the fact that they regulate retail rates and portfolios and do not try to “reach back upstream” to effect the wholesale price directly.³³⁹

Additionally, FERC has permitted a New York law that provides subsidies based on real estate tax incentives to pass through the capacity market unfettered. FERC allowed the subsidy because it

choose to require a utility to construct generation capacity of a preferred technology or to purchase power from the supplier of a particular type of resource.” S. Cal. Edison Co., 70 FERC 61,215, 61,676 (1995).

335. See *supra* Part II.B.

336. *Id.*

337. 16 U.S.C. § 824(b)(1) (2006).

338. See *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 205 (1983); *New York v. FERC*, 535 U.S. 1, 24 (2002) (FERC's authority does “not affect or encroach upon state authority in such traditional areas as . . . administration of integrated resource planning and utility buy-side and demand-side decisions, including DSM [demand-side management]; [and] authority over utility generation and resource portfolios . . .” (quoting FERC Order No. 888, 62 Fed. Reg. 12,274, 31,782 n. 544 (Mar. 14, 1997) (codified at 18 C.F.R. pt. 35)) (first alteration in original)); *Ferrey*, *supra* note 85, at 616.

339. See *Ferrey*, *supra* note 85, at 618.

determined the tax incentive “was granted ‘as of right’ and was not discretionary.”³⁴⁰ Thus, the issue of what constitutes an impermissible subsidy that affects market prices is still unclear.³⁴¹ On the one hand, price manipulation can be permissible if it is done under one of the state’s resource planning initiatives; yet on the other hand, FERC has stated that if states try to set an above-market price, they are required to mitigate it.³⁴² This seems to be a “distinction without a difference” because in either case the price of the wholesale market is affected.³⁴³

In conclusion, for states to avoid preemption, state laws that incentivize generation must be careful not to set wholesale prices directly. Instead, they must use their traditional authority of regulating retail rates and generation portfolios to fulfill their purpose of promoting new in-state generation. The ability of states to regulate public utilities has always been within the state police power,³⁴⁴ and the ability to determine state energy policy has traditionally served important state interests of providing for the economic welfare and public safety of the state. At the very least, a court is less likely to find preemption if the state law promotes important state interests that have been traditionally regulated by state governments.³⁴⁵

B. Dormant Commerce Clause

If a state’s program to incentivize generation is upheld on preemption grounds, the state law can still be attacked through the Commerce Clause. The Commerce Clause provides Congress with the power “[t]o regulate commerce . . . among the several States.”³⁴⁶ While this is an affirmative grant of power to Congress, it has been inferred by the Supreme Court to limit a state’s ability to place an undue burden on interstate commerce.³⁴⁷ As will be discussed below,

340. Stark & Simon, *supra* note 228, at 33.

341. *Id.*

342. *See id.*

343. *Id.*

344. Ark. Elec. Coop. Corp. v. Ark. Pub. Serv. Comm’n, 461 U.S. 375, 377-78 (1983) (citing *Munn v. Illinois*, 94 U.S. 113 (1877)). This right was reiterated by the Supreme Court when it recognized that the “[n]eed for new power facilities, their economic feasibility, and rates and services, are areas that have been characteristically governed by the States.” *Pac. Gas & Elec. Co.*, 461 U.S. at 205.

345. *See* CHEMERINSKY, *supra* note 283, at 409.

346. U.S. CONST. art. I, § 8, cl. 3.

347. *E.g.*, *Healy v. Beer Inst., Inc.*, 491 U.S. 324, 326 n.1 (1989) (“This Court long has recognized that this affirmative grant of authority to Congress also encompasses an implicit or ‘dormant’ limitation on the authority of the States to enact legislation affecting interstate commerce.”) As Felix Frankfurter explained: “What Marshall merely adumbrated in *Gibbons v. Ogden* became central to our whole constitutional scheme: the doctrine that the commerce clause, by its own force and without national

a state legislature must be careful not to promote generation at the expense of neighboring states. While the courts have granted some leeway if a law burdens commerce only incidentally, while promoting a legitimate state concern, states must nonetheless ensure that the burden on interstate commerce is not excessive. This section will first explain current jurisprudence under the dormant commerce clause. It will then try to delve into the effect it could have on LCAPP and similar state initiatives that try to promote new generation.

1. Current Court Standards Under Dormant Commerce Clause Jurisprudence

The Court has articulated a doctrine known as the dormant commerce clause, which provides that in the event that Congress has not preempted state law, or alternatively reserved an area of regulation for the states,³⁴⁸ a court will still strike down a state law that “unjustifiably . . . discriminate[s] against or burden[s] the interstate flow of articles of commerce.”³⁴⁹ The Court believed that in granting plenary power to the Federal government over interstate commerce, the framers sought to “avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.”³⁵⁰ However, the Commerce Clause does not restrict all state regulation that might have an effect on interstate commerce.³⁵¹ The key question the court asks is whether the state

legislation, puts it into the power of the Court to place limits upon state authority.” FELIX FRANKFURTER, *THE COMMERCE CLAUSE UNDER MARSHALL, TANEY AND WAITE* 18 (Peter Smith ed. 1978) (1937).

348. Under dormant commerce clause jurisprudence, a state law that would otherwise be found unconstitutional will be upheld if Congress has approved the state regulation. However, in regards to state regulation under the FPA, Congress has not given such approval. Ferrey, *supra* note 85, at 579, 588 (“[T]here is nothing in the legislative history or language of the Federal Power Act that indicates any intent ‘to alter the limits of state power otherwise imposed by the Commerce Clause.’” (quoting *United States v. Pub. Util. Comm’n of Cal.*, 345 U.S. 295, 304 (1953); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982)) (citing *Pennsylvania v. West Virginia*, 262 U.S. 553 (1923); *West v. Kansas Natural Gas Co.*, 221 U.S. 229 (1911))).

349. *Or. Waste Sys., Inc. v. Dep’t of Env’tl. Quality of State of Or.*, 511 U.S. 93, 98 (1994); *accord H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 534-38 (1949); *Welton v. Missouri*, 91 U.S. 275 (1876); *Cooley v. Bd. of Wardens*, 53 U.S. 299 (1851).

350. *Or. Waste Sys., Inc.*, 511 U.S. at 98 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 325-26 (1979)); *see H.P. Hood & Sons, Inc.*, 336 U.S. at 537-38 (“This principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control of the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units.”); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 523 (1935) (Cardozo, J.) (“[The Constitution] was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division.”).

351. *See, e.g., Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 306-07 (1997) (The

statute discriminates against out-of-state businesses or whether it treats both in-state and out-of-state businesses alike.³⁵² The primary purpose of the dormant commerce clause is to protect against “economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.”³⁵³

Under current jurisprudence, courts will apply “different levels of judicial scrutiny” depending on the “type and design of [the] state regulation.”³⁵⁴ There are two different types of discriminatory schemes identified by the court. First, a state law or regulation will be considered facially discriminatory if, by its terms, the law draws a distinction between in-state and out-of-state commerce.³⁵⁵ Second, a state law is likely to be found discriminatory if, although neutral on its face, it nonetheless discriminates through its effect or the court determines the law was passed for underlying protectionist

Commerce Clause was “never intended to cut the States off from legislating on all subjects relating to the health, life, and safety of their citizens, though the legislation might indirectly affect the commerce of the country.” (quoting *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 443-44 (1960) (internal quotation marks omitted)); *Maine v. Taylor*, 477 U.S. 131, 138 (1986) (“The limitation imposed by the Commerce Clause on state regulatory power ‘is by no means absolute,’ and ‘the States retain authority under their general police powers to regulate matters of ‘legitimate local concern,’ even though interstate commerce may be affected.” (quoting *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 36 (1980))).

352. See, e.g., *Hughes*, 441 U.S. at 336 (stating that the first part of the analysis is “whether the challenged statute regulates evenhandedly with only ‘incidental’ effects on interstate commerce, or discriminates against interstate commerce either on its face or in practical effect”); *Taylor*, 477 U.S. at 138 (“[T]his Court has distinguished between state statutes that burden interstate transactions only incidentally, and those that affirmatively discriminate against such transactions.”); *Or. Waste Sys., Inc.*, 511 U.S. at 99 (“As we use the term here, ‘discrimination’ simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter. If a restriction on commerce is discriminatory, it is virtually *per se* invalid.”).

353. *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273-74 (1988) (citing *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270-273 (1984); *H.P. Hood & Sons, Inc.*, 336 U.S. at 532-533; *Guy v. Baltimore*, 100 U.S. (10 Otto) 434, 443 (1879)); CHEMERINSKY, *supra* note 283, at 431 (“The framers were most concerned about stopping protectionist state legislation where a state would discriminate against out-of-staters to benefit its citizens at the expense of out-of-staters.”).

354. *Ferrey*, *supra* note 85, at 579.

355. See, e.g., *Or. Waste Sys., Inc.*, 511 U.S. at 99 (holding a state law that imposed additional costs to dispose of waste generated out-of-state waste than it did waste generated in-state was facially discriminatory); *Hughes*, 441 U.S. at 337 (finding a state law that tried to restrict the exportation of minnows discriminatory and noting that “[s]uch facial discrimination by itself may be a fatal defect, regardless of the State’s purpose”); *City of Philadelphia v. New Jersey*, 437 U.S. 617, 628 (1978) (finding a New Jersey law facially discriminatory because it kept local landfills exclusively for use by New Jersey’s citizens).

purposes.³⁵⁶

First, where the state law clearly, on its face, discriminates against interstate commerce, the Court has consistently held those laws unconstitutional.³⁵⁷ Courts will strike these types of protectionist laws as virtually *per se* unconstitutional.³⁵⁸ However, there are exceptions, especially where a state can prove the law was passed for a purpose unrelated to economic protectionism.³⁵⁹ Based on this knowledge, it is highly unlikely that a state would pass a law to promote new generation that facially distinguishes between in-state and out-of-state commerce. It is more likely that a state will try to promote generation through a facially neutral law and the subsequent challenge would allege discriminatory effect or purpose.

Second, a facially neutral law will be struck down if its effect or impact on interstate commerce is discriminatory.³⁶⁰ The Court's

356. See, e.g., *C & A Carbone, Inc. v. Town of Clarkstown* 511 U.S. 383, 391 (1994) (finding a state law that required all waste to be processed at a designated transfer station discriminatory, even though the law did not differentiate based on geographic origin); *Hunt v. Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 335, 350-52 (1977) (finding a state law that required all shipments of apples imported and sold into the state to bear "no grade other than the applicable U.S. grade or standard" unconstitutional because, although neutral on its face, the law had "the practical effect of not only burdening interstate sales of Washington apples, but also discriminating against them" (citation omitted)).

357. E.g., *Or. Waste Sys.*, 511 U.S. at 109; *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 274 (1988); *Hughes*, 441 U.S. at 337; *City of Philadelphia*, 437 U.S. at 628; *Dean Milk Co. v. Madison*, 340 U.S. 349, 354 (1951). Many of these types of facially discriminatory laws take the form of: 1) an express disadvantage to out-of-state-business; 2) laws that try to protect a state's natural resources; 3) reciprocity requirements; and 4) local or municipal laws that treat in-state and out-of-state commerce alike, but nonetheless try to insulate or promote local businesses from outside competition. See CHEMERINSKY, *supra* note 283, at 431-36.

358. *Or. Waste Sys.*, 511 U.S. at 100 ("Because the Oregon surcharge is discriminatory, the virtually *per se* rule of invalidity provides the proper legal standard here . . ."); *City of Philadelphia*, 437 U.S. at 624 ("[W]here simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected."); *Hughes*, 441 U.S. at 337 ("[F]acial discrimination by itself may be a fatal defect" and "[a]t a minimum . . . invokes the strictest scrutiny.").

359. *Maine v. Taylor*, 477 U.S. 131, 151 (1986) (upholding a state law that prohibited the importation of baitfish into the state due to environmental concerns because the Court found that "[a]s long as a State does not needlessly obstruct interstate trade or attempt to 'place itself in a position of economic isolation,' it retains broad regulatory authority to protect the health and safety of its citizens and the integrity of its natural resources," especially when the local concern "could not adequately be served by available nondiscriminatory alternatives" (quoting *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935))).

360. E.g., *C & A Carbone*, 511 U.S. at 394-95; *Hunt*, 432 U.S. at 350-54. *But see Minnesota v. Clover Leaf Creamery*, 449 U.S. 456 (1981) (upholding a state law that prohibited the sale of milk in plastic containers but allowed the sale of milk in paper containers even though there was proof of discriminatory purpose); *Exxon Corp. v. Governor of Md.*, 70 U.S. 117 (1978) (upholding a state law that prohibited a producer or refiner of petroleum products from operating retail service stations within the state

assessment of the discriminatory effect is done on a case-to-case basis; however, the Court has had a hard time articulating clear criteria that will cause a neutral state regulation to be deemed discriminatory.³⁶¹ The Court has paid particular attention to whether the state law places additional costs on out-of-state businesses that in-state businesses would primarily not have to bear.³⁶² Additionally, the Court looks unfavorably upon state laws that, if implemented, would necessarily exclude out-of-state competition from doing business in state, or alternatively, state laws that require use of local businesses.³⁶³ Since a court's appraisal of the facts and circumstances is determinative as to whether it finds a facially neutral law unconstitutional, it is hard to predict how a court will rule in regards to state attempts to develop new generation. Obviously, it will depend upon how the state fashions the law or regulation. This will be discussed in more detail below.

Additionally, since the Court is primarily concerned with stopping protectionist legislation, an underlying theme throughout dormant commerce clause jurisprudence is the Court's classification of the legislative intent. When deciding whether the state objective is for protectionist purposes, the Court usually starts its determination with the text of the statute or regulation and decides whether, from its plain meaning, the law has protectionist motives.³⁶⁴ Other factors the Court takes into consideration include the law's legislative history and statements made by the legislature before the law was passed.³⁶⁵ However, the Court has noted that it "is not bound by '[t]he

even though the majority of the burden fell on out-of-state producers and refiners).

361. CHEMERINSKY, *supra* note 283, at 436.

362. *Id.*

363. *Id.* at 436, 438.

364. *Perry v. Commerce Loan Co.*, 383 U.S. 392, 400 (1966) ("There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes. Often these words are sufficient in and of themselves to determine the purpose of the legislation. In such cases we have followed their plain meaning." (quoting *United States v. Am. Trucking Ass'n*, 310 U.S. 534, 543 (1940))); *see, e.g.*, *Am. Beverage Ass'n v. Snyder*, 700 F.3d 796, 805 (6th Cir. 2012) ("To determine whether a state regulation purposefully discriminates within interstate commerce, we turn to the actual language in the statute.").

365. Factors in whether state regulation has discriminatory purpose, and thus potentially violates dormant commerce clause, include:

- 1) statements by lawmakers;
- 2) the sequence of events preceding the regulation's adoption, including irregularities in the procedures;
- 3) the state's consistent pattern of discriminating against, or disparately impacting, a particular class of persons;
- 4) the regulation's historical background, including whether it has been historically used to discriminate; and
- 5) the regulation's use of highly ineffective means to promote the legitimate interest asserted by the state.

IESI AR Corp. v. Nw. Ark. Reg'l Solid Waste Mgmt. Dist., 433 F.3d 600, 604 (8th Cir. 2006).

name, description or characterization given it by the legislature or the courts of the State,' but will determine for itself the practical impact of the law."³⁶⁶

Interestingly, the Court recently explained that laws governing a "government function [are] not susceptible to standard dormant commerce clause scrutiny owing to its likely motivation by legitimate objectives distinct from the simple economic protectionism the Clause abhors."³⁶⁷ In sum, a law will be found discriminatory if it either discriminates against interstate commerce on its face, or if it is facially neutral but nonetheless discriminates through its disparate impact or its underlying purpose. As will be discussed next, the Court's determination in this matter is decisively important in determining whether the state law will be upheld or struck down.

If the court finds that the state regulation does discriminate against interstate commerce, then the court will apply a strict scrutiny analysis and will only uphold the law if it is necessary to achieve a "legitimate local purpose,"³⁶⁸ and this "purpose could not be served as well by available nondiscriminatory means."³⁶⁹ The Court's presumption of unconstitutionality against discriminatory state laws makes the burden on the state very high. The Supreme Court recently noted that "[s]tate laws that discriminate against interstate commerce face 'a virtually *per se* rule of invalidity."³⁷⁰ The only way a

366. *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979) (quoting *Lacoste v. La. Dep't of Conservation*, 263 U.S. 545, 550 (1924)).

367. *Dep't of Revenue of Ky. v. Davis*, 553 U.S. 328, 341 (2008) (citing *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 343 (2007)); *United Haulers*, 550 U.S. at 342-43 (distinguishing between "public and private entities" and stating that treating them "the same under the dormant Commerce Clause would lead to unprecedented and unbounded interference by the courts with state and local government"); *id.* at 343 ("[W]hen a law favors in-state business over out-of-state competition, rigorous scrutiny is appropriate because the law is often the product of 'simple economic protectionism. Laws favoring local government, by contrast, may be directed toward any number of legitimate goals unrelated to protectionism." (citations omitted)).

368. *See, e.g., Granholm v. Heald*, 544 U.S. 460, 489 (2005); *Maine v. Taylor*, 477 U.S. 131, 138 (1986); *Sporhase v. Nebraska*, 458 U.S. 941, 954 (1982); *Hunt v. Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 350 (1977) (noting that the Court must consider whether a state law "furthers matters of legitimate local concern"); *see also C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 402 (1994) (O'Connor, J., concurring) ("Where, however, a regulation 'affirmatively' or 'clearly' discriminates against interstate commerce on its face or in practical effect, it violates the Constitution unless the discrimination is demonstrably justified by a valid factor unrelated to protectionism."). Although the Court characterizes the standard as a "legitimate" purpose, which is usually the language used to describe the deferential "rational basis review," scholars generally surmise that the Court nevertheless requires the law to "serve an important purpose," which is more in line with strict scrutiny review. *See CHEMERINSKY, supra* note 283, at 444.

369. *Taylor*, 477 U.S. at 138.

370. *Granholm*, 544 U.S. at 476 (quoting *Philadelphia v. New Jersey*, 437 U.S. 617,

state can rebut such a presumption is to show that the purpose of the discriminatory law is important, or at the very least, that it is unrelated to protectionism.³⁷¹ Furthermore, the state must prove that the law is necessary—the least restrictive means—to achieve its nonprotectionist purpose.

On the other hand, if the court determines that a state law is nondiscriminatory, this does not signify the state is in the clear. If this is the case, the court will use a balancing test, and the state law will be upheld if its effect on interstate commerce is only incidental, while fulfilling the state's legitimate purpose.³⁷² Under this test, commonly referred to as the *Pike* balancing test, a state law is likely to be upheld so long as its benefit outweighs its burden on interstate commerce.³⁷³ The Court in *Pike* explained the test as follows: "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."³⁷⁴ Since the law is nondiscriminatory, and therefore does not implicate protectionist purposes, the court is less likely to find the law unconstitutional.

The court's deference to the state law is magnified if the state is exercising traditionally recognize police powers, including protection of health, safety, environment, and welfare. In these instances, the Court has recognized "the legitimate state pursuit of such interests as compatible with the Commerce Clause, . . . [even] 'though the legislation might indirectly affect the commerce of the country.'"³⁷⁵ Furthermore, courts have noted that "[t]he *Pike* balancing is carried out in light of [the judiciary's] hesitation to interfere in internal policy decisions traditionally vested with local governments."³⁷⁶

The last inquiry into whether nondiscriminatory laws are upheld is whether there are alternate means to effectuate the stated

624 (1978)).

371. "At the very least, a state law that discriminates against interstate commerce must be justified by a purpose that is 'unrelated to economic protectionism.'" CHEMERINSKY, *supra* note 283, at 444 (quoting *Fort Gratiot Sanitary Landfill, Inc. v. Mich. Dep't of Natural Res.*, 504 U.S. 353, 359 (1992)).

372. See *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

373. Ferrey, *supra* note 85, at 581 ("Under the so-called *Pike* balancing test, the challenged statute must advance a legitimate public interest without imposing a burden on commerce that is clearly excessive in relation to the local benefits." (citing *Pike*, 397 U.S. at 142)).

374. *Pike*, 397 U.S. at 142.

375. *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 306-07 (1997) (quoting *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 443-44 (1960)).

376. *E.g.*, *Lebanon Farms Disposal, Inc. v. Cnty. of Lebanon*, 538 F.3d 241, 250 (3d Cir. 2008).

purpose.³⁷⁷ It is not necessary, however, for the state to demonstrate that the law is the least restrictive alternative.³⁷⁸ Therefore, in the case of nondiscriminatory regulations, the court's determination of the legislative purpose is the crucial inquiry that determines whether the state law will be upheld.

In conclusion, the critical determinant in a dormant commerce clause analysis is the court's initial conclusion on whether the state law is discriminatory. Also important is the court's determination of whether the law is discriminatory based upon protectionist purposes. Because the judicial standard differs between regulations that do and do not discriminate, the conclusion of the court as to whether the law is discriminatory or evenhanded is likely to be determinative of whether the state law is upheld or invalidated.

2. An Analysis of LCAPP Under the Commerce Clause and How a State Can Navigate the Dormant Commerce Clause Minefield

The method in which a state creates its law to promote energy generation will be determinative of whether it passes constitutional muster. Obviously, laws that are discriminatory on their face will likely be struck down as constitutionally impermissible, even if the state purports to have a legitimate purpose. A state must be skillful in crafting a law that does not discriminate based on point of origin regulation—meaning, the regulation does not differentiate between out-of-state generation and in-state generation. The court scrutinizes point of origin regulation heavily, especially when the regulation favors “local interests to the detriment of interstate commerce.”³⁷⁹ Consequently, the state's promotion of generation must be done evenhandedly, giving both in-state and out-of-state developers an equal chance to receive the benefits of the state law.

The start of the court's dormant commerce clause analysis of LCAPP will begin with a determination of whether it discriminates

377. *Pike*, 397 U.S. at 142 (“And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.”); *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 473 (holding state law constitutional because “no approach with ‘a lesser impact on interstate activities’ is available” (quoting *Pike*, 397 U.S. at 142)).

378. See *Clover Leaf Creamery*, 449 U.S. at 472-73 (upholding state statute despite the fact that it promoted local industry at the expense of out-of-state industry); CHEMERINSKY, *supra* note 283, at 440 (“[T]he Court never has invalidated a nondiscriminatory state law on the ground that the goal could be achieved through a means that is less burdensome on interstate commerce.”); Ferrey, *supra* note 85, at 581-82 (“[W]ith such a balancing it is not necessary to demonstrate that the state statute is necessarily the least restrictive means to accomplish the stated purpose.”).

379. Ferrey, *supra* note 85, at 580 (citing *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 392 (1994)).

against interstate commerce. By its terms, LCAPP does not facially discriminate against out-of-state developers of generation. This is evidenced by the qualification method for the set market price. To become a “prequalified eligible generator” under the program, a developer must take part in a bidding process administered by the state’s Agent.³⁸⁰ An eligible generator is defined as “a developer of a base load or mid-merit electric power generation facility including, but not limited to, an on-site generation facility that qualifies as a capacity resource under PJM criteria and that commences construction after the effective date of [the LCAPP Act].”³⁸¹ Based on this definition, the LCAPP Agent identified three “eligibility conditions” that developers must satisfy before advancing to the “prequalification review phase.”³⁸² The three eligibility conditions were: (1) the “[p]roposed project must be a base load or mid-merit electric power generation facility”; (2) the “[p]roposed project must qualify as a capacity resource under PJM criteria”; and (3) the “[p]roposed project must be a new electric generation facility that did not begin construction on or before January 28, 2011.”³⁸³

Once a developer has been deemed to be an “eligible generator,” it could seek to become “prequalified” by a showing of its “environmental, economic, and community benefits, and through demonstration of reasonable certainty of completion of development, construction and permitting activities necessary to meet the desired in-service date.”³⁸⁴ At the end of the bidding process the Agent would select among the prequalified eligible generators those that had the greatest “net benefit to ratepayers” based on the generators offer price and term.³⁸⁵ Lastly, those generators that could begin operations for delivery year 2015 would be given weighted preference.³⁸⁶ The selected generators would then be submitted to the Board of Public Utilities for final approval.³⁸⁷

Based upon the above criteria, there is no facial discrimination between in-state and out-of-state developers since each has an equal chance, at least from the statute’s terms, of becoming a prequalified eligible generator. The next step will be for the court to determine whether, despite its facial neutrality, LCAPP discriminates through its effect or purpose. This is a factual determination that requires an analysis of the burdens placed on interstate commerce, with particular attention to burdens that are disparate in their treatment

380. See N.J. STAT. ANN. § 48:3-98.3 (West 2012).

381. *Id.* § 48:3-51.

382. LEVITAN & ASSOCIATES, INC., *supra* note 199, at 28.

383. *Id.*

384. § 48:3-98.3(b)(2); LEVITAN & ASSOCIATES, INC., *supra* note 199, at 28.

385. § 48:3-98.3

386. *Id.*

387. *Id.*

of in-state versus out-of-state industry. If the court finds such disparate impacts, the court will then determine if those impacts result from protectionist motives.

LCAPP is an indirect subsidy from the New Jersey government in that it requires utilities, under traditional state regulatory powers, to subsidize the higher market price, which is then paid for by the ratepayers in New Jersey. The funding mechanism in this case is paid for by a rate increase on in-state consumers, and not levied against the sale of interstate electricity because the rate increase is a separate charge on ratepayers' electricity bills.³⁸⁸ This distinction is important because courts have been troubled when the funding mechanism of a subsidy is imposed on interstate commerce and those who are out-of-state are not eligible for the subsidy.³⁸⁹ Ordinarily, subsidies of an in-state industry are not prohibited by the dormant commerce clause.³⁹⁰ Only when those subsidies are paid for by out-of-staters does the court find a violation of the Commerce Clause.³⁹¹ This is partly due to the rationale that the Clause is supposed to protect states and their citizenry from laws in other states passed with a protectionist purpose, where the out-of-staters lack political representation.³⁹² Consequently, the New Jersey charge on ratepayers is distinct from "traditional instruments of protectionism," such as tariffs or quotas.³⁹³

Furthermore, the out-of-state industry in this case is not

388. See § 48:3-98.3(d) ("The board shall order the full recovery of all costs associated with the electric public utilities' resulting SOCAs, and the costs of the agent retained . . . from ratepayers through a non-bypassable, irrevocable charge.").

389. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199-200 (1994).

390. See *id.* at 199 n.15 ("We have, however, noted that '[d]irect subsidization of domestic industry does not ordinarily run afoul' of the negative Commerce Clause." (quoting *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988)) (alteration in original)).

391. *Id.* at 199-200.

392. *Id.* at 200 (striking down a state law that imposed a nondiscriminatory tax on the milk industry but then used that tax to subsidize the in-state milk industry as unconstitutional partly because the "State's political processes [could] no longer be relied upon to prevent legislative abuse"); CHEMERINSKY, *supra* note 283, at 422 (stating that there is "a political justification for the dormant commerce clause: States and their citizens should not be harmed by laws in other states where they lack political representation").

393. Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1094-95 (1986). Regan argues that "a state statute . . . is protectionist if and only if: (a) the statute . . . was adopted for the purpose of improving the competitive position of local (in-state) economic actors, just because they are local, vis-à-vis their foreign . . . competitors; and (b) the statute . . . is analogous in form to the traditional instruments of protectionism—the tariff, the quota, or the outright embargo (all of which can be on imports or exports)." *Id.*; see *West Lynn Creamery, Inc.*, 512 U.S. at 193 ("Because of their distorting effects on the geography of production, tariffs have long been recognized as violative of the Commerce Clause.").

necessarily prohibited from qualifying for the subsidy. The initial test for eligibility is based on objective standards, and the second test for prequalification only requires a showing of the “environmental, economic, and community benefits” to New Jersey.³⁹⁴ Although the second test is more subjective, it is not prohibitive on its face since out-of-state generators can still theoretically show that their plant has “environmental, economic, [or] community benefits.”³⁹⁵ An examination of the LCAPP Agent’s report, shows that from thirty-four developers that bid into the LCAPP program, twenty-five of them did not make it past the eligibility stage³⁹⁶—meaning they did not meet the objective criteria set out by the Agent. The remaining nine bidders that were eligible were all New Jersey developers; therefore, the less objective test for prequalification could not be tested to see if it was discriminatory towards out-of-state developers.³⁹⁷ Thus, the results are inconclusive; however, because the statute does not discriminate facially, the inference should be that its effects are nondiscriminatory.

Next, the court is going to scrutinize the purpose of LCAPP. If it is found that it is protectionist legislation, then the Court will likely find that it violates the Commerce Clause. The court looks first to the text of the statute.³⁹⁸ The legislative findings assert that LCAPP was passed “[t]o address the lack of incentives under the reliability pricing model” and to promote “the construction of new, efficient generation.”³⁹⁹ Furthermore, the law purports to remedy a number of problems related to relieving “electrical system reliability concerns caused by transmission system overloads or the lack of local generation.”⁴⁰⁰ The problems identified in the legislative findings relate to “electric power capacity deficit[s] and high power prices that may result in the loss of jobs and investment.”⁴⁰¹ The legislative findings end with the statement that:

Fostering and incentivizing the development of a limited program for new electric generation facilities will help ensure sufficient

394. N.J. STAT. ANN. § 48:3-98:3 (West 2012).

395. *See id.*

396. LEVITAN & ASSOCIATES, INC., *supra* note 199, at 38 (“Of the 25 ineligible facilities, 21 were eliminated because they were tied to existing generation units and therefore did not meet the condition of being a new generation facility. Four projects were eliminated because they were categorized as peaking units, rather than exhibiting the base load or mid-merit operating regime required by the LCAPP Law.”). All of the out-of-state developers and some New Jersey developers that bid into LCAPP were eliminated at this stage. *See id.* at 39.

397. *See id.* at 40.

398. *See, e.g.,* Perry v. Commerce Loan Co., 383 U.S. 392, 400 (1966) (quoting United States v. Am. Trucking Ass'ns, 310 U.S. 534, 543 (1940)).

399. N.J. STAT. ANN. § 48:3-98.2 (West 2012).

400. *Id.*

401. *Id.*

capacity to stabilize power prices to assist the State's economic development and create opportunities for employment in the energy sector while helping to reduce the cost and volatility of electricity prices in New Jersey.⁴⁰²

Depending on the interpretation of these findings, a court could come out either way. On the one hand, the statute's primary concern is ensuring reliability and relief to the congested grid, which would fall under the traditional state interests of protecting the welfare and safety of the state. On the other, there seems to be undertones that suggest that it was merely enacted to promote local economic development and employment. With either interpretation, New Jersey's purposes are legitimate. However, the courts have applied strict scrutiny to state laws that were enacted simply to promote job creation or economic development, if by doing so, they unduly burden interstate commerce.⁴⁰³

Depending on how the court comes out on the issue of discrimination, either strict scrutiny or the *Pike* balancing test will be used. If the court classifies LCAPP as discriminatory, then New Jersey will have an uphill battle to prove that its purpose is important and that it is the least restrictive alternative. However, even if LCAPP is found discriminatory it might not be fatal. Since LCAPP Law is not facially discriminatory in how it operates, New Jersey can point to the traditional state powers of utility regulation, especially generation, and concerns over the safety and welfare of the state.

Under a *Pike* balancing test, New Jersey's LCAPP will most likely be upheld. Since under this test the court has found the law nondiscriminatory, New Jersey only has to show that "the burden imposed on interstate commerce" is not "clearly excessive in relation to the putative local benefits."⁴⁰⁴ New Jersey's purported purpose, that its constituents retain access to reliable, economic, efficient, and environmentally responsible electric supply, would definitely be considered legitimate.⁴⁰⁵ Even if the Court characterizes the purpose

402. *Id.*

403. *See, e.g., West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 (invalidating state law that used a nondiscriminatory tariff to subsidize and promote the in-state dairy industry).

404. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

405. *See* N.J. STAT. ANN. § 48:3-98.2(d), (i) ("To address the lack of incentives under the reliability pricing model, the construction of new, efficient generation must be fostered by State policy that ensures sufficient generation is available to the region Fostering and incentivizing the development of a limited program of new electric generation facilities will help ensure sufficient capacity to stabilize power prices . . . [and] help[] to reduce the cost and volatility of electricity prices in New Jersey."); § 48:3-98.3 (prequalification for the LCAPP program requires a showing of the "environmental, economic, and community benefits" and final recommendation for program requires the LCAPP Agent to evaluate the "net value to ratepayers" of the

as promoting local interests, so long as the law regulates evenhandedly, it will be characterized as legitimate.⁴⁰⁶ Lastly, the means of LCAPP does not even have to be the least restrictive alternative, thus arguments that reliability concerns could be brought less restrictively through rule changes in the PJM or, alternatively, expansion of transmission facilities would not need to be disproved.

In conclusion, for state laws that try to promote generation, states must construct their laws in a way that does not facially discriminate against interstate commerce. Instead, laws subsidizing generation should deal evenhandedly to both in-state and out-of-state developers. State regulations that simply protect the local economy will usually be struck down. However, if the state is exercising traditionally recognized legitimate purposes—including protection of health, environment, natural resources, and safety—it has a reasonable chance of surviving a constitutional challenge.⁴⁰⁷

C. The Role of State Government: A Policy Perspective

Electric energy affects every aspect of our society and allows us to live with the comforts and amenities that we have become accustomed to. As such, it is of vital importance to the economy and social well-being of each state.⁴⁰⁸ The question that looms over regulation after the April 12 Order is what role a state should have in reliability and pricing in an RTO-controlled—FERC-mandated—environment.⁴⁰⁹ This section contends that when there is a market failure, the federal government must not impede a state's ability to intervene to ensure reliable service at a reasonable cost for its citizens. The use of LCAPP and the PJM energy markets provide an important example of the growing conflict across the country. The PJM energy and capacity markets are the largest in the country.⁴¹⁰ As such, PJM is used as a model to many of the other RTOs around the nation. New Jersey is at the forefront of this issue, and as demand increases and regional energy markets expand, there will be continued and growing conflict to determine the role of states in a

“eligible generator's offer price and term”); N.J. Assemb. Comm. State., 214-A.B. 3442 (2010) (“The creation of LCAPP is expected to reduce the cost of energy for New Jersey residents . . . [and] is also intended to further New Jersey's policy of promoting the use of clean and efficient generation”); NEW JERSEY ENERGY MASTER PLAN, *supra* note 152, at 22 (LCAPP was intended to provide “economic, environmental and reliability benefits.”).

406. *See, e.g.*, *Minnesota v. Clover Leaf Creamery*, 449 U.S. 456, 471 (1981).

407. *See Ferrey, supra* note 85, at 643-45.

408. Swartwout, *supra* note 6, at 292 (“Our utility industry is both a large and a critical component of our national economy and has become an absolutely necessary element of the way we all live, and expect to live.”); *see supra* note 11.

409. April 12 Order, *supra* note 225.

410. *See* AM. PUB. POWER ASS'N, *supra* note 149.

federally controlled market.

The right of states to ensure reliability at a reasonable price has been a cornerstone of energy regulation since the inception of the electricity industry. Every piece of legislation, from the Federal Power Act to the EAct of 2005, either explicitly or implicitly asserts a state's right to pursue legitimate policy interests in determining the composition of its energy supply to suit its environmental, social, and economic needs. The states have traditionally been able to consider both the "need" for new generation and the economic feasibility of a project,⁴¹¹ while maintaining control over the rates and service of retail distribution,⁴¹² in order to guarantee reliable service in such a way as to balance public policy with reasonable costs. The bright lines elucidated by courts shortly after the enactment of the FPA continued for several decades; however, even when these lines became convoluted after subsequent legislation, one thing remained clear: states continued to have the ability and responsibility to ensure reliability for their citizens.

This ability was demonstrated after the enactment of PURPA, which provided the incentives for nonutility-owned generation to enter the market, but the new plants were built upon a foundation that states controlled. State public utility commissions remained the arbiter in which developers sought permission to build new generation. PUCs would first determine whether there was a need for new generation. This granted them wide-ranging control to set policy goals within their state energy plans. State commissions could make a determination based on a balancing of several factors including reliability, environmental impact, and economic and safety concerns.⁴¹³

The passage of the EAct of 2005 was the last major energy policy ratified by Congress, and it amended the FPA to expand federal jurisdiction to areas that had been traditionally left to state regulation. Nonetheless, one thing that remained constant was the desire to preserve a state's right to ensure reliability. In § 1211, which gave authority to FERC to certify Electric Reliability Organizations ("ERO") to "establish and enforce reliability standards for the bulk-power system[s],"⁴¹⁴ Congress provided savings provisions.⁴¹⁵ The savings provisions were twofold. First, they reiterated that neither the Commission nor the ERO could order

411. See *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 205 (1983).

412. *Id.*

413. See Public Utility Regulator Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3121, 3122 (codified at 16 U.S.C. § 2621(c) (2006)).

414. Electricity Modernization Act of 2005, Pub. L. No. 109-58, 119 Stat. 941, 941 (codified at 16 U.S.C. § 824o(a)(2) (2006)).

415. *Id.* at 945 (codified at 16 U.S.C. § 824o(i) (2006)).

construction of additional generation capacity or set safety and adequacy standards for electric facilities.⁴¹⁶ Second, they preserved the state's right to take action to "ensure the safety, adequacy, and reliability of electric service within that State, as long as such action [was] not inconsistent with any reliability standard."⁴¹⁷ Therefore, a state could take action to ensure the reliability of electric service within its state so long as that action did not lower reliability or otherwise go against the federally determined reliability standard.

Additionally, recent FERC orders have highlighted the legitimate interests of states to control development of new capacity in order to advance state and local policies. It has only been since the April 12 Order that the ability of states to exercise their constitutional privilege has become unclear. In 2006, the Commission approved a settlement between PJM and several PJM market participants concerning rule changes to the RPM, including those relating to the MOPR.⁴¹⁸ In response to a challenge to the "state mandated exception" within the MOPR, the Commission found the exception reasonable because "it enable[d] states to meet their responsibilities to ensure local reliability."⁴¹⁹ The April 12 Order is a departure from the reasoning in the 2006 Settlement since FERC allowed PJM to eliminate the state mandate. Nonetheless, FERC reiterated that states do have a legal right to "pursue legitimate policy interests" in determining generation development.⁴²⁰

For over a hundred years, state regulation has been a major force in the electric industry, and it must continue to exist in order for states to meet their legal responsibility to provide for the safety and welfare of their citizens. If it is true that there is a reliability concern, then it is a state's prerogative to ensure there is enough electric generation. There is no question that it is within a state's sovereign power to ensure reliability in the electric industry. The FPA states it, the Supreme Court has upheld it, and FERC has confirmed it. The question, then, is what can states do on their own to fix the problem? There might be several methods, but state subsidies, which are approved by state legislatures and signed into law by state governors, should be a legitimate answer to capacity shortfalls. State legislatures and governors will be directly accountable to their citizens if there is an electricity shortage that could cause controlled brownouts or blackouts in their state due to

416. *Id.*

417. *Id.*

418. PJM Interconnection, LLC, 117 FERC 61,331 (2006).

419. *Id.* at 62,671 & n.75 (applying the state mandate to any planned generation facility that was being developed "in response to a state regulatory or legislative mandate to resolve a projected capacity shortfall in the delivery year affecting that state").

420. April 12 Order, *supra* note 225, at 61,106.

failure in regulatory oversight. It would be much harder for an injured citizen to obtain redress from the federal government when his or her power goes out. On the other hand, if some responsibility is left with state government, these citizens at least are able to use their voting power to ensure their elected representatives are working for their best interests.

Finally, states are in the best position to address capacity shortfalls and can use a variety of legislative and regulatory tools to address reliability concerns while promoting the public interest. States regulate the utilities in their respective state and can determine the rates that those utilities charge at retail.

State and municipal authorities retain the right to forbid new entrants from providing new capacity, to require retirement of existing generators, to limit new construction to more expensive, environmentally-friendly units, or to take any other action in their role as regulators of generation facilities without direct interference from the Commission.⁴²¹

Furthermore, states are the only ones that can fully regulate generation facilities and generation siting. In contrast, FERC cannot order generation to be built nor can they order current generating facilities to expand. The Commission and PJM would prefer to fix congestion by increasing or uprating transmission facilities or by decreasing demand. Although these are effective methods, and conservation is a worthy tactic for addressing both environmental and economic concerns, they are not the only methods to reduce congestion and increase reliability. States are in the best position to employ a third option—creating incentives for new generation when and where it is needed most.

Regardless of the fate of LCAPP to withstand the constitutional or regulatory attacks, the conflict between the interests of state legislatures and regulators to provide reliable energy at a reasonable price for its citizens and federal energy policy to promote competitive markets will remain. If state initiatives are found unconstitutional, a congressional mandate clarifying this right would be the most appropriate answer since Congress has plenary power over interstate commerce and can authorize state laws or explicitly reserve from them the right to regulate. As demand increases and regional energy markets expand, and perhaps even become a national market,⁴²² there will be continued and growing conflict between state and federal jurisdiction. This conflict will remain unless there is a

421. Conn. Dep't of Pub. Util. Control v. FERC, 569 F.3d 477, 481 (D.C. Cir. 2009).

422. See Martin Rosenberg, *Reshaping Federal Transmission Policy*, ENERGYBIZ MAGAZINE, Mar./Apr. 2012, available at <http://www.energybiz.com/magazine/article/258005/reshaping-federal-transmission-policy> (interviewing Jon Wellinghoff, chairman of the U.S. Federal Energy Regulatory Commission, who predicts that in twenty years there will be a national transmission grid).

regulatory scheme that will balance states' legitimate interests with federal energy policy. State and federal regulation must return to the era of "cooperative federalism" in order to ensure the viability of the competitive market as the heart of a capitalist economy.