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MEMORANDUM

TO: Ohio Manufacturers' Association Energy Group Members

FROM: Kimberly W. Bojko and Ryan P. O'Rourke, Carpenter Lipps & Leland LLP

DATE: April 19, 2016

SUBJECT: Summary of U.S. Supreme Court decision invalidating Maryland's plan to guarantee a capacity payment to a generator distinct from the PJM wholesale auction rate

The U.S. Supreme Court recently upheld a lower court's decision, holding that a Maryland Public Service Commission (Maryland PSC) plan to boost in-state generating capacity with subsidies paid by ratepayers unlawfully intruded on the Federal Energy Regulatory Commission's (FERC) jurisdiction over wholesale rates. The Maryland PSC required the local utilities to enter into a 20-year purchase power agreement or contract for differences (PPA) with the generating company selected to construct a new power plant in Maryland. Under the PPA, the generating company sold its capacity into the PJM market. If PJM market revenues received by the generating company fell below the contractual rate, the utilities were then required to pay the generator the difference between the PJM clearing price and the contractual rate. In turn, the utilities passed these costs onto customers. If PJM market revenues exceeded the contractual rate, the generating company paid the utilities the difference between the contractual rate and the clearing price. In turn, the utilities passed these credits back to customers in the form of lower rates. In either event, the generator ultimately received the contractual rate set by the 20-year PPA, not the rate that cleared the PJM capacity auction.

The Court affirmed that FERC has the exclusive authority to set wholesale energy and capacity prices and oversee whether those rates and charges are just and reasonable. In the exercise of this authority, the Court observed that "FERC has approved the PJM capacity auction as the sole ratesetting mechanism for sales of capacity to PJM, and has deemed the clearing price per se just and reasonable." The problem with the Maryland PSC's plan, the Court explained, was that the PPA guaranteed the generator a rate distinct from the clearing price set in PJM's capacity auction. By departing from this ratesetting mechanism, the Maryland PSC impermissibly veered into "FERC's regulatory turf."

The Court rejected the Maryland PSC's argument that the plan was authorized because it was an attempt to spur new in-state generation, stating "States may not seek to achieve ends, however, legitimate, through regulatory means that intrude on FERC's authority over interstate wholesale rates [.]". The Court also refuted the Maryland PSC's contention that the plan was indistinguishable from a traditional bilateral contract. Unlike a traditional bilateral contract, the generator sold its capacity into the PJM auction as opposed to selling its capacity directly to a utility.

The Court concluded by noting that its decision does not address the permissibility of State measures that encourage new generation through tax incentives, land grants, direct subsidies, state-constructed generation, or re-regulation. Those measures, however, must be "untethered to a generator's wholesale market participation."

The Court's decision bolsters OMAEG's position in the AEP and FirstEnergy PPA cases. Just like in the Maryland case, the PPAs in the AEP and FirstEnergy cases guarantee a rate that is distinct from the clearing price set in PJM's capacity auction. The PPAs at issue in the AEP and FirstEnergy cases guarantee a payment to the generators different from the clearing price set in the PJM auction. OMAEG has argued that this type of arrangement, just like in Maryland, impermissibly interferes with FERC's authority to oversee wholesale rates as the guaranteed revenue stream from customers will make the affiliate generating units agnostic to wholesale-market prices, distort wholesale-market price signals, and deter new entry from competitive generation suppliers.

To date, the PUCO has declined to address the federal preemption argument, reasoning that the issue is better suited to resolution by a court rather than an administrative agency. In the upcoming application for rehearing process, OMAEG will cite to the recent Supreme Court decision as grounds for invalidating AEP's and FirstEnergy's PPA mechanisms. Nonetheless, given the PUCO's previous evasion of the issue, the PUCO may continue to decline to address the issue and force parties to seek court resolution.