To say the least, government regulation of the energy industry is a complex, multifaceted affair.

On the one hand, interstate markets and operations clearly fall within the domain of federal regulators—in particular, the Federal Energy Regulatory Commission (FERC). Yet coexisting with federal authority is the power of the states to regulate matters of local concern—most notably, retail rates, production, and the like. The explicit reservation of a role for the states in this scheme of concurrent jurisdiction has been beyond question since Congress promulgated the nascent Federal Power Act over 80 years ago.

What industry activities fall within the regulatory ambit of FERC and which matters are best left to state oversight?

Questions still abound—primarily, where does one draw the lines that confine each body of regulators to its own rightful sphere of influence? What industry activities

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fall within the regulatory ambit of FERC, and which matters are best left to state oversight? Moreover, when the actor is a state itself, how does one square its endeavors with the supremacy of federal mandates?

The final arbiter of such weighty questions is, of course, the US Supreme Court. As previously explicated in these pages, in the last four years alone the Court has issued no less than three key landmark decisions that more or less clearly segregate the respective purviews of national and state regulatory power over the industry. Most recently, a case decided by one of the nation’s more prestigious appeals courts might provide an opportunity for the Court to elaborate yet again upon that jurisprudence.

At the heart of Coalition for Competitive Electricity v. Zibelman,1 we find a program established by New York State to subsidize certain of its in-state nuclear generators until other forms of zero-carbon production could replace these old and unprofitable atomic plants. Over the objections of competing interstate producers who asserted the aid program impermissibly interfered with exclusive federal authority over the wholesale electricity markets, the US Court of Appeals for the Second Circuit deemed the plaintiffs’ claims to lack merit, and, accordingly, dismissed the complaint before a trial was ever held.

Two key aspects make Coalition worthy of discussion. The first is the potential for US Supreme Court review. The second is the even more intriguing possibility that other jurisdictions, encouraged by the validation of the New York aid program, might replicate Coalition within their own bailiwicks.

In either eventuality, the best starting point for our studies is a brief overview of the relevant Supreme Court landmark decisions upon which both shall pivot.

THE NOBLE TRIAD

As extensively discussed in prior issues, the Supreme Court within this last decade has promulgated a trilogy of decisions affirming the supremacy of federal regulation over the nation’s interstate wholesale markets, while concomitantly restricting state dominion to local retail markets and producers.

The first part of this noble triad is Oneok, Inc. v. Learjet, Inc.,2 which established the supremacy of federal law over state promulgations in the matter of regulating the natural gas industry. Oneok’s signature achievement is a contemporary declaration of the axioms of field preemption and conflict preemption, the guiding principles that articulate the constitutional edict that federal law reigns supreme over local law.

The former doctrine proclaims that when Congress intends federal law to occupy the field, all state regulation must be swept away; the latter works to nullify any local law that contradicts or confounds national legislation. These maxims, as espoused in Oneok, are critical to understanding the case at hand, and furthermore divining the dichotomy between federal and state authority over the energy sector in all such controversies.

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Oneok was soon followed by FERC v. Electric Power Supply Association (EPSA),3 which rendered an analogous holding with respect to the regulation of the interstate wholesale market in electricity. EPSA unequivocally found that arena subject exclusively to FERC’s oversight, for reason of the supremacy of federal law. A key takeaway from EPSA is that when matters truly implicate the interstate market for electricity, FERC is the paramount regulator, to the exclusion of state prerogatives.

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1 ___ F.3d ___ (2d Cir. September 27, 2018) (Coalition).


Completing this controlling triumvirate was *Hughes v. Talen Energy Marketing, LLC.* There the justices confronted a Maryland program that promoted the development of new, local generation facilities. Notwithstanding the parochial aims of the state’s incentives, a unanimous Supreme Court declared that the aid package amounted to an unconstitutional trespass into the federal sphere of energy regulation. Nevertheless, a united Court did provide some tacit direction as to what state endeavors would pass muster pursuant to the teachings of *Hughes.* The justices unequivocally indicated that some forms of local assistance, such as land grants, tax incentives, and the like, might not be prohibited by constitutional axioms of federal supremacy.

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We end this overview of precedential background here because it was *Hughes* that played a particularly influential role in shaping the Second Circuit’s opinion in *Coalition.* We are now prepared to examine the latter ruling.

**COALITION’S FACTUAL BACKGROUND**

Some explanation of the circumstances giving rise to the *Coalition* litigation is obligatory; even so, we comment that the Second Circuit made surprisingly short shrift of the underlying facts. So as to fully inform the reader here, we supplement the few matters deemed significant by the panel with a retelling of necessary points of interest, as set forth in an earlier writing.

The crux of the matter was the financial assistance given by the State of New York to a select group of nuclear generators within its jurisdiction. First, the tribunal carefully noted that nuclear operators do business under their own peculiar set of realities. On the one hand, they can boast of at least one laudable characteristic: they emit no carbon pollution.

On the other, the intrinsic nature of atomic plants is that they cannot vary their output according to market prices: nuclear generators must sell their entire production into regional grids at the prevailing rate, even if selling at such a price renders them unprofitable. Given such undeniable existential facts, certain atomic plants situated in New York were sustaining untenable losses, and, no longer able to justify such unprofitability, their operators threatened to permanently retire these nuclear facilities.

Next, the panel related how local authorities were unwilling to do without the carbon-free attributes of nuclear generation, at least until, in the words of the Second Circuit, other sources of clean, renewable energy could pick up the slack. To avert this supposed environmental dilemma, New York decided it would render financial assistance to three atomic plants, thereby enabling these nuclear generators to stem their losses and remain open.

Accordingly, the state inaugurated a program of zero-emission credits (ZECs). And here, without mincing words, the Second Circuit unabashedly categorized the assistance program as a subsidy.

Claiming that the ZEC program violated the twin principles of field preemption and conflict preemption, a coalition of nonnuclear producers from outside the Empire State, joined by a number of individual producers, brought suit. The material part of their argument was that New York’s regime of highly selective assistance distorted the outcomes of interstate power auctions by propping up nuclear generators that would otherwise exit the wholesale market. To be sure, it was beyond dispute that each of the atomic plants destined to receive the ZECs sold electricity into the regional grid, and thereby participated in FERC-regulated wholesale auctions.

The prime defendant, the New York State Public Service Commission, then moved to dismiss the proceeding before trial. After a

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lower-court judge granted that motion, this appeal followed.

**ZECs NOT BARRED BY FIELD PREEMPTION**

In the American court system, the nominal function of an appellate court is to review the law and ascertain if it was correctly applied by the trial court.

The Second Circuit turned to that important task, dealing in order with the plaintiffs’ contentions respecting field preemption and conflict preemption. Remarkably swift in rendering its judgment, the Coalition court first declared that New York’s subsidy to its in-state nuclear generators was not prohibited by principles of field preemption.

The panel first described how federal law has long admitted a shared responsibility for regulating the energy industry between FERC and state authorities. Writing for the tribunal, Judge Dennis Jacobs explained that the former unquestionably enjoys exclusive jurisdiction over the interstate market for electricity, yet its authority is delimited to matters that directly affect wholesale prices. In contradistinction, the latter’s ambit appropriately extends over producers found within their respective jurisdictions, provided that local regulation (or, in the case at hand, assistance) does not conflict with federal prerogatives.

Citing extensively the Supreme Court’s latest proclamations in Hughes, the Second Circuit focused almost exclusively upon the language therein that the states retain the power to render aid to energy companies via measures “untethered” to a generator’s participation in the wholesale markets. The tribunal interpreted the Supreme Court’s language as permissive of tax incentives, land grants, and direct subsidies, provided that such state largesse was not predicated upon the beneficiary participating in the national markets that fall subject to federal oversight.

Among the panel’s principal findings, it concluded that the ZECs would be allocated without reliance upon outcomes in the competitive auctions for wholesale electricity. This finding stood in contradistinction to the Maryland aid package overturned in Hughes, where the Supreme Court found the program in controversy there unlawful because it conditioned assistance upon the recipient participating in the interstate market.

The panel declared that nothing in New York’s aid package required the ZEC beneficiaries to sell into the wholesale auctions. Interestingly, the circuit court admitted that the nuclear generators at issue here might well sell all their production into the federally regulated marketplace, nevertheless, the producers were not obliged to do so as a precondition to receiving state assistance.

In fact, the panel explicitly proclaimed the ZEC regime was “unbundled” from the wholesale market, another point of dissimilarity from the subsidy invalidated by the Supreme Court in Hughes. As an additional finding, the Second Circuit concluded that the ZEC program’s principal objective was to render assistance on the basis of the environmental attributes of in state producers and not to usurp federal priorities.

When all was said and done, the Coalition panel pointedly declared that “New York’s scheme avoids (or skirts) the Hughes prohibition.” Indeed, the appellate court significantly amplified that comment later on in its opinion, subsequently noting that the state had kept in its sights the line dividing federal and local regulation into distinct spheres of authority. And in yet another pungent comment, Judge Jacobs wryly noted that New York had “gone as near as can be without crossing” that constitutional boundary.

For all these reasons, the Second Circuit rejected the plaintiffs’ claims that the ZEC program violated principles of field preemption. The tribunal now turned to address the claim of unconstitutionality as a matter of conflict preemption.

**NOR WAS THERE CONFLICT PREEMPTION**

Notwithstanding that the Second Circuit spent considerably less time analyzing the conflict preemption dimension of the case here, the court’s conclusions remained unchanged. Just as it found New York’s aid to its nuclear generators did not violate principles of field preemption, it likewise found that the ZECs did not run counter to the rules of conflict preemption.
From the outset of this portion of its analysis, the tribunal stressed that conflict preemption is a doctrine to be gently applied in such situations. Writing for the panel, Judge Jacobs reminds that Congress deliberately crafted a scheme of divided influence over the nation’s energy industry. The judiciary is duty-bound to defer to such legislative choices and, accordingly, must not rush to displace the states from their proper role. For these reasons, the Coalition court posited that it would not apply the axiom of conflict preemption here unless there was unequivocal evidence that the ZECs would do harm to federal mandates.

To be certain, the plaintiffs did vigorously allege precisely such damage. They reiterated their basic tenet that New York’s helping hand buoyed unprofitable atomic plants that would otherwise have been driven out of business, enabling nuclear operators to continue to sell their output into the regional grid, unfettered by worries over profitability. Thus, the ZECs seriously distorted prices arrived at in the wholesale bidding exclusively superintended by FERC.

Once more, the Second Circuit unabashedly rejected such claims. The tribunal characterized the ZECs as having, at worst, an incidental effect upon the competitive auctions. The court was steadfast in its reasoning that the provision of ZECs was merely a lawful exercise of New York’s authority over local producers and not an illegitimate incursion into territory constitutionally reserved for national regulation.

Addressing the more-positive attributes of Coalition first, we concur in the panel’s overarching recognition of the long-established fact that regulation of the energy industry is a joint affair, with responsibility allocated between the federal government and state authorities. The court was inarguably correct in declaring that oversight of the interstate markets falls on the federal side of the ledger, in contradistinction to the continuing role of the states in regulating local producers.

Likewise, the court’s tight focus on Hughes is also worthy of praise. The Second Circuit wisely pointed to the language of a unanimous Supreme Court that mapped out alternatives for state aid, which should not collide with maxims of field or conflict preemption. Yet notwithstanding these laudatory aspects of the Second Circuit’s decision, we remain troubled. We are uncertain if the court fully comprehended the ZECs’ true influence over the interstate wholesale auctions in electricity, and therefore whether or not the court was correct in decreeing that New York’s beneficence in this affair did not intrude upon federal supremacy.
Likewise, we are quite mindful of the Second Circuit’s equally blunt observation that the ZECs come so very close to the line separating what state intervention is allowable from what is prohibited. Notwithstanding that the Coalition panel correctly identified the lines drawn by the Supreme Court in Hughes, we ponder if the right choice was made in declaring which side of the line New York’s aid program did indeed fall.

Additionally, we must remind that the Coalition court dismissed this proceeding at the pleading stage—in other words, without a trial. One is left to wonder if a complete evidentiary proceeding might have had a different result. That uncertainly is troubling by itself.

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Our final and great concern is this: will other jurisdictions, emboldened by New York's success in this case, decide the time is right to inaugurate similar programs of assistance to local producers? No doubt such initiatives will test the boundaries of the reigning Supreme Court trilogy, most especially Hughes, and shall therefore be highly influential upon how the energy sector is regulated, and by whom.

Will other jurisdictions, emboldened by New York's success in this case, decide the time is right to inaugurate similar programs of assistance?

SUPREME COURT MUST INTERVENE

At the end of the day, the Second Circuit has now decreed that New York's assistance to its nuclear generators does not violate maxims of field preemption nor conflict preemption. We await and, indeed, hope for Supreme Court review, so we might have clarity on this important issue of where the precise boundaries lie for federal and state regulation of the energy industry. Of equal importance, we now set about the further task of carefully monitoring the other states for their independent reactions to the affirmation of state authority over the energy industry, as found in Coalition.

The thought that consumes us most is the following: were it not for New York's charity, it is fairly obvious that this select grouping of nuclear generators would have exited the wholesale market. But now, unfettered by concerns over profitability, they continue to participate in the competitive auctions selling power into the regional grid. Does that not, by itself, constitute a usurpation of exclusive federal authority over the interstate wholesale market? Our concern is that the Coalition court did not appreciate that by altering who participates in the marketplace, New York invaded a domain exclusively reserved for federal oversight.

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Next, we find it difficult to draw a principled distinction between New York’s underwriting of its nuclear generators and the Maryland subsidy overturned by the Supreme Court in Hughes. The Supreme Court unanimously invalidated the latter program because it conditioned state aid upon the producer selling into the interstate markets. The ZECs upheld by the Second Circuit in Coalition kept unprofitable atomic plants in a market they were about to exit.

In our view, the undeniable commonality is that both local aid schemes inserted or preserved a participant in an interstate market where FERC is the sole supervising authority. Accordingly, we have difficulty discerning an actual difference between the two state assistance packages, in either function or result. Both keep in a wholesale market an entity that would otherwise be absent. Surely, that is a meaningful intrusion upon federal hegemony.

Furthermore, the panel opinion is most revealing where it places this controversy in counterpoise to the recent promulgations of the Supreme Court. We take most seriously Judge Jacobs’s arch comments that New York’s chosen form of aid “avoids (or skirts)” the problems identified by the justices in Hughes.

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