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FEDERAL AND STATE REGULATORY UPDATE

May 13, 2014

FEDERAL MATTERS

1. United States Supreme Court

A. *Environmental Protection Agency v. EME Homer City Generation, LP* (Apr. 29, 2014)

On April 29, 2014, the United States Supreme Court upheld the EPA's Cross-State Air Pollution Rule ("Transport Rule"), which implemented the Clean Air Act's ("CAA") Good Neighbor Provision by regulating NO_x and SO_2 from upwind states. The decision was 6-2, with Justices Scalia and Thomas dissenting and Justice Alito abstaining. The decision reverses the D.C. Circuit decision that vacated the Transport Rule in its entirety.

Under the Good Neighbor Provisions of the CAA, State Implementation Plans are required to address emissions that "contribute significantly" to nonattainment in other states. The Transport Rule was promulgated by the EPA to define when upwind states "contribute significantly" to nonattainment in downwind states, after its first attempt, the Clean Air Interstate Rule ("CAIR"), was disapproved of by the D.C. Circuit. Under the Transport Rule, an upwind state "contribute[s] significantly" when its exported pollution both produced a one percent or more increase of a National Ambient Air Quality

Standards ("NAAQS") pollutant in the downwind state and it could be eliminated cost-effectively. The D.C. Circuit threw out the Transport Rule, holding that the EPA must disregard costs when implementing the Good Neighbor Provision; rather, it could only consider upwind states' physically proportionate responsibility for the air quality violations downwind.

The court upheld the Transport Rule as permissible, efficient, and equitable. The rule is permissible, according to the court, because the EPA is delegated the authority to implement the Good Neighbor Provision by the CAA and nothing in the provision precludes using costs in determining upwind contributions to nonattainment. The rule is efficient because the EPA can reach the same levels of emission reductions as the D.C. Circuit's proportionality interpretation at much lower costs. Further, the rule is equitable because it subjects states that have done less to reduce emissions to stricter regulation.

In addition, the court rejected two other D.C. Circuit objections to the cost-based Transport Rule. First, the lower court claimed that the rule might subject upwind states to "over-control," where "a State might be compelled to reduce emissions beyond the point at which every affected down-wind State is in attainment." Second, the lower court observed that it was possible, under the cost-based rule, for an upwind state to "be required to reduce its emissions by so much that the State no longer contributed one percent or more of a relevant NAAQS to any downwind State." The court rejected the first argument because the EPA has leeway in balancing between possibilities of over- and under-control, especially considering how slight changes to wind patterns or energy consumption make the calculation of down-wind air quality imprecise. The court rejected the second argument because a challenge to that rare situation should be brought as an as-applied challenge; this possibility did not warrant vacating the entire rule on a facial basis.

2. United States Court of Appeals for the District of Columbia Circuit

A. *TC Ravenswood LLC v. Federal Energy Regulatory Commission* (Dec. 13, 2013)

On December 13, 2013, the D.C. Circuit denied petitions for review of FERC orders that suspended the NYISO's proposed 2011-14 demand curves for over five months. In the orders, FERC found that a property tax exclusion in the proposed demand curves was unreasonable. FERC suspended the proposed demand curves for five months—the statutory maximum for a suspension of this nature—to allow the NYISO to correct the problem. NYISO submitted a filing to enable the preexisting demand curves to remain in place beyond the five-month suspension, which FERC accepted. Petitioners sought rehearing on the suspension period issue, but were denied. This court had expounded a standard for this type of challenge in an earlier case: "[s]o long as the Commission's reasons are 'in some way relevant to [its] statutory inquiries,' we will remand only if the Commission 'impos[es] two different suspension lengths in cases that [a]re absolutely indistinguishable' or imposes a suspension length 'plainly and absolutely foreclosed' by existing rules or precedent." Petitioners' argument that FERC had imposed different suspension lengths in indistinguishable cases was rejected. According to the court, the suspension period imposed by FERC was the five-month maximum; any time period beyond the five months was the result of FERC merely accepting the NYISO's voluntary delay in implementing new demand curves. According to the court, nothing in the Federal Power Act ("FPA") prohibited FERC from accepting such a voluntary delay.

3. *United States District Court for the District of Maryland*

A. *PPL Energyplus, LLC v. Nazarian* (Sept. 30, 2013)

On September 30, 2013, the District Court held that the Maryland Public Service Commission's ("MDPSC") order requiring electric distribution companies ("EDCs") to enter into a

contract for differences with a generator for the construction of a new generation facility was preempted by the FPA and violated the Supremacy Clause of the United States Constitution.

The court held that, because the FPA grants exclusive jurisdiction to FERC over the regulation of wholesale electricity rates and sales, the MDPSC order, which established the wholesale rate that the generator would be paid under the contract for differences, was preempted. The MDPSC began requiring EDCs to seek out new generation by issuing RFPs for new gas-fired generation and sign contracts for differences with the winning bidder. The MDPSC started using this process to address the public policy concern that Maryland did not itself contain adequate generation to meet the needs of the market. The court held that, while incentivizing new generation is a legitimate state goal, wholesale pricing was solely within the purview of FERC's powers. According to the decision, the contract for differences was not a purely financial contract, which may have been exempt from FERC's jurisdiction, because it required construction and operation of a new plant and dictated how the new generation would participate in the markets. In addition, according to the court, the contract compensated the generator for wholesale capacity sales to PJM, which, again, is within FERC's exclusive jurisdiction under the FPA.

The court went on to hold that the order did not, however, violate the dormant Commerce Clause because it did not discriminate against the flow of interstate commerce. The order did not create "any barriers to the sale or transmission of electric energy at wholesale in and out of SWMAAC and within the PJM region or to providing a competitive advantage to an in-SWMAAC generation facility selling electric energy at wholesale at the expense of other generation facilities competing in the same market;" rather, facilities would still have to compete in PJM markets like any other resource.

The United States Court of Appeals for the Fourth Circuit will hear the appeal to this case on May 13, 2014.

4. United States District Court for the District of New Jersey

A. *PPL Energyplus, LLC v. Hanna* (Oct. 11, 2013)

On October 11, 2013, the District Court held that the New Jersey Long-Term Capacity Pilot Project ("LCAPP") was preempted by the FPA and, thus, unconstitutional because it violated the Supremacy Clause. LCAPP, enacted in 2011, authorized the construction of gas-fired generators in or near New Jersey to "address the lack of incentives [to create new capacity] under the reliability pricing model [("RPM")]." LCAPP required electric distribution companies ("EDCs") to enter into contracts with new generators that "obligate[d] these EDCs to pay any difference between the RPM Auction price and their actual development costs." Ultimately, in theory, LCAPP would incentivize the construction of new generation within the PJM that would benefit New Jersey.

Initially, the court held that LCAPP violated the Supremacy Clause through the doctrine of field preemption. FERC has demonstrated a dominant federal interest and a pervasive federal regulatory structure by regulating wholesale electricity sales through the RPM. Arguments that the required contracts were purely financial instruments, and, thus, outside the purview of FERC jurisdiction, were rejected.

Next, the court held that LCAPP also violated the Supremacy Clause through the doctrine of conflict preemption. LCAPP "pose[d] as an obstacle to [the FERC's] implementation of the RPM" by undermining generation and marketing companies' ability to use RPM price signals in making various business decisions. Any expansion of these companies would now be contingent upon the market effects of LCAPP. Therefore, the required contracts conflicted with the FERC's "preferred method for the wholesale sale of electricity in interstate commerce."

While LCAPP was invalidated on Supremacy Clause grounds, the court did hold that the statute did not violate the dormant Commerce Clause. New Jersey relied on voluminous evidence to

show that it had higher capacity prices than other areas in the PJM due to transmission costs and closer generation would alleviate those costs. In addition, the record supported the assertion that closer generation would also address reliability issues. Therefore, "the incentive for community benefits to generators in New Jersey appear[ed] reasonable."

Oral argument was held on March 27, 2014, at the United State Court of Appeals for the Third Circuit.

5. *Federal Energy Regulatory Commission*

A. Docket No. ER14-500-000, *New York Independent System Operator, Inc., Order Accepting Tariff Filing Subject to Condition and Denying Waiver* (Jan. 28, 2014)

On January 28, 2014, FERC issued an order accepting the NYISO's proposed tariff revisions, which defined the demand curves for the ICAP market for the 2014/15, 2015/16, and 2016/17 Capability Years. FERC also approved the establishment of the first demand curve for the new locality encompassing Load Zones G, H, I, and J ("G-J Locality"). However, FERC rejected NYISO's proposal to phase-in the new demand curves for the G-J Locality, finding "that a phase-in will not ensure that market-clearing prices will guide efficient investment decisions to add or retire capacity resources and meet reliability needs in this region."

The most contentious issue concerned the choice of proxy unit technology. NYISO proposed to use an F class frame combustion turbine with selective catalytic reduction (SCR) technology as the proxy unit for the NYC, Long Island, and Lower Hudson Valley zones. Rejecting myriad arguments pertaining to the weakness of an SCR proxy unit, FERC accepted the NYISO's decision, holding that the only reviewable requirement for choosing a proxy unit technology is the physical ability to supply capacity to the market. NYISO chose an F class frame combustion turbine without SCR for the New York Control Area. FERC accepted this decision, holding that a cap on operating hours would ensure compliance with environmental permits.

In addition, FERC held other NYISO decisions to be reasonable as well. It was reasonable for NYISO to exclude property taxes from its calculations, despite uncertainty as to whether tax abatement programs would continue. It was also reasonable for the NYISO to reduce its thirty-year amortization period for proxy units to twenty years because significant investment would be required to reach thirty years.

STATE MATTERS

1. Court of Appeals

A. *Thrun v. Cuomo* (Apr. 3, 2014)

On April 3, 2014, the New York State Court of Appeals denied a motion for leave to appeal the Third Department's decision in *Thrun v. Cuomo*, a case involving New York's participation in the Regional Greenhouse Gas Initiative ("RGGI"). The Third Department dismissed a complaint that sought injunctive relief against enforcement of RGGI, a regional carbon dioxide cap-and-trade program that is applicable to generation facilities. The decision to participate was made administratively by the New York State Department of Conservation and the New York State Energy Research and Development Authority; thus, any challenge would be subject to CPLR article 78's four-month statute of limitations. The challenge was dismissed by the Supreme Court, and then the Third Department, because the statute of limitations had run. Furthermore, challenges to the Governor's authority to sign a memorandum of understanding with the other participating governors were moot. The memorandum was merely an agreement to propose the RGGI; therefore, invalidating the memorandum would have no effect on New York's participation.

2. New York State Public Service Commission

A. Case 13-E-0199, *In the Matter of Electric Vehicle Policies, Declaratory Ruling on Jurisdiction over Publicly Available Electric Vehicle Charging Stations* (Nov. 22, 2013)

On November 22, 2013, the PSC issued a ruling declaring that it does not have jurisdiction over publicly available electric vehicle charging stations, the owners or operators of these stations, or transactions between owners or operators and the public. The Public Service Law grants the PSC jurisdiction over electric plants and the electric corporations that operate such plants. The PSC held that charging stations are not electric plants because they are not "used for or in connection with or to facilitate the generation, transmissions, distribution, sale or furnishing of electricity for light, heat or power." Rather, the stations provide a single service: they charge electric vehicles' batteries. The public is merely purchasing this service from owners or operators; using the electricity is incidental to the transaction. Further, because the stations are not electric plants, the owners or operators are not electric corporations; therefore, they, too, are outside the PSC's jurisdiction.

B. Case 12-E-0577, *Proceeding on Motion of the Commission to Examine Repowering Alternatives to Utility Transmission Reinforcements, Term Sheet Agreement between National Grid and Dunkirk Power LLC Regarding Dunkirk Generation* (Feb. 13, 2014)

On February 13, 2014, National Grid filed a proposed Term Sheet Agreement, between it and Dunkirk Power LLC ("Dunkirk"), with the PSC. "Under the Term Sheet, National Grid will pay Dunkirk $20.41 million per year for ten years ($150 million net present value ("NPV")) and Dunkirk will add gas-fired capability to electric generating units 2, 3 & 4 (nominally 435 MW) and operate such units for ten years commencing approximately September 1, 2015."

In its Statement in Support of the agreement, National Grid argues that keeping the plant operational and repowering it with natural gas would mitigate reliability impacts while transmission upgrades are developed. In addition, according to National Grid, repowering Dunkirk would provide the NYISO with flexibility in using resources from Niagara Power Project and Ontario control area. Furthermore, National Grid asserted the economic benefits behind the agreement, such as providing jobs and tax revenue.

C. Case 12-T-0502, ***Proceeding on Motion to Examine Alternating Current Transmission Upgrades*****, and Case 13-E-0488,** ***In the Matter of Alternating Current Transmission Upgrades – Comparative Proceeding, Order Authorizing Modification of the Process to Allow for Consideration of Alternative Proposals*** **(Feb. 21, 2014)**

On February 21, 2014, the PSC issued an order "direct[ing] the ALJs to establish a process that will offer the current applicants [for AC upgrade projects] an opportunity to submit alternatives to their existing proposals," with a focus on projects that can be contained within existing rights-of-way. The order also modified the proceeding by allowing submission of projects that produced less than 1,000 MW of increased transfer capability "to allow for as broad a range of potential solutions as possible." This order is the latest development in the proceeding to alleviate AC transmission congestion across New York, an issue highlighted by the Draft State Energy Plan. On March 19, 2014, the PSC published a notice soliciting comments, for 45 days, in regards to this order. Some comments urged the PSC to make AC transmission upgrades a public policy objective, adopt a contract or tariff approach for cost recovery for non-incumbents, and support risk mitigation proposals that benefit ratepayers. Other comments argued that the PSC is preempted from taking action that conflicts with FERC's exclusive jurisdiction over cost allocation and recovery.

D. Case 14-T-0017, *Proceeding on Motion of the Commission to Develop an Expedited Process for Siting Transmission on Existing Rights-of-Way, Order Instituting Proceeding* (Feb. 21, 2014)

On February 21, 2014, the PSC issued an order "initiat[ing] a proceeding for the purpose of establishing an expedited process for Article VII applicants who propose to build within existing utility or state-owned rights-of-way." In addition to limiting the expedited process to projects in existing rights-of-way, the PSC noted that expedited review should be reserved for projects that are unlikely to have significant environmental impacts. The initiation of this proceeding came on the heels of Governor Cuomo's proposal—during his 2014 State of the State address—that an expedited process be adopted for "smart" transmission projects that do not require new private rights-of-way.

The PSC instructed DPS Staff to hold a technical conference and develop a proposal to ensure such projects' applications could be processed within ten months. The technical conference was held on April 11, 2014; Staff's proposal was released on May 2, 2014. The proposal allows applicants to request expedited, ten-month Article VII review for projects that meet the following eligibility requirements:

> (1) the facility is proposed to be located wholly within existing transmission rights-of-way and/or buried within existing state-owned rights-of-way except for any de minimus deviations; (2) the facility would not result in structures taller than those presently located on the existing rights-of-way or the change in height is de minimus; (3) the facility would not require expanding the width of the existing rights-of-way or the change in width is de minimus; and, (4) the applicant is not requesting waiver of any application filing requirements described in the Commission's rules or has already received such waivers in advance of submitting the application.

The grant of expedited review could be revoked by an ALJ or a PSC determination that it is not in the public interest. Comments on Staff's proposal are due by June 2, 2014.

E. Case 13-E-0012, *Dynegy Danskammer, LLC, Order Adopting Emergency Action on a Permanent Basis and Establishing Further Procedures* (Mar. 28, 2014)

On March 28, 2014, the PSC issued an order that made its October 28, 2013, emergency order, which substituted Helios Power Capital LLC ("Helios") for Dynegy Danskammer LLC ("Dynegy Danskammer") as the party responsible for filing a notice of retirement for the 530 MW Danskammer Generation Facility (the "facility"), permanent. The PSC previously readopted the October 28 emergency order in an order issued January 22, 2014.

Originally, pursuant to an order issued April 22, 2013, the facility was set to permanently retire, after which it would no longer be subject to PSC jurisdiction. Dynegy Danskammer was required to permanently retire the facility before it could be transferred to a new owner. However, in light of a shift in market conditions, expected to result in increased prices, the facility's proposed new owner, Helios, wanted to maintain the option of operating the facility rather than it being permanently retired. The PSC issued the March 28 emergency order to allow for reconsideration of the retirement finding from the April 22 order: "[t]he emergency action was necessary because, without it, [the April 22 order] posed an untoward obstacle to re-entry of the Danskammer facility into wholesale competitive markets in the wake of the FERC's approval of the new Hudson Valley ICAP Zone."

In December 2013, the PSC began soliciting comments on whether the October 28 emergency order should be adopted permanently. Opponents, including IPPNY, argued that the emergency action is contradictory to FERC decisions and jurisdiction, and the retirement of facility was required and irreversible. Further, they argued that the order did not constitute an emergency under the State Administrative Procedure Act ("SAPA"); thus, notice and comment procedures were required but ignored.

The PSC held that retirement was not required because the October 28 order extended the seven-day notice period prescribed in the April 22 order, which was the only possible retirement mandate. In addition, the facility never actually retired because Helios did not file a notice of permanent retirement; rather, on March 13, 2014, Helios announced that it would seek reconsideration of the retirement finding. Because of this announcement, the PSC noted that the emergency action is ripe for permanent adoption. However, Helios's request for reconsideration would be the subject of a new PSL § 70 proceeding.

Furthermore, the PSC held that the possibility of the facility resuming operations "would dovetail with FERC's expectations for the new ICAP Zone." According to the PSC, FERC has stressed that the new price signals are intended to, *inter alia*, incentivize the restoration of generation capacity. It is up to Helios to examine economic price signals and decide whether to retire the facility. The PSC also held that PSL § 70 had been complied with throughout the proceeding. Section 70, according to the PSC, while requiring approval of the transfer of a generation facility, "does not prescribe any procedures or timeframes through which approval of a transaction must be considered."

Moreover, according to the PSC, the emergency outlined in the October 28 and January 22 orders satisfied the requirements of the SAPA. The rate increase within the new ICAP zone sufficiently described the nature and location of the emergency. The notice and comment requirements could not have been complied with because Helios had to be substituted before the April 22 order's seven-day notice period expired in order maintain the opportunity to offset the rate increase. The SAPA requires the PSC, after a statutory time period, to extend the emergency order, allow it to lapse, or make it permanent. The PSC held that, because the emergency action should not be allowed to lapse and an extension would serve no purpose, the emergency order is to be permanent.

On April 1, 2014, Helios and Danskammer filed a joint application for expedited approval of the lease, sale, and operation of the facility under lightened regulations. The PSC opened the new proceeding under Case 14-E-0117. IPPNY's comments expressed "concern that the Facility will return to service with the support of an above-market contract, not as a merchant facility relying solely on market prices. Central Hudson countered that IPPNY's arguments against Danskammer returning to service were merely speculative, to which IPPNY replied that it "only objects to Danskammer returning to service if it does so pursuant to an exercise of buyer-side market power."

F. Case 12-E-0503, *Proceeding on Motion of the Commission to Review Generation Retirement Contingency Plans, Order Denying Request for Rehearing and Motion for Clarification* (Apr. 1, 2014)

On April 1, 2014, the PSC denied a petition for rehearing and a motion for clarification filed in regards to the PSC's November 4, 2013, acceptance of the Indian Point Energy Center ("IPEC") contingency plan ("IPEC plan"). The IPEC plan, which would address reliability concerns in the event that IPEC is retired in 2015, included transmission projects ("TOTS") and the addition of demand response/combined heat and power resources ("DR/CHP"). In addition, the November 4 order considered cost recovery mechanisms, with the PSC supporting the NY Transco cost allocation mechanism, which allocated costs according to a formula developed by the New York Transmission Owners ("NYTOs"), and recovered costs for TOTS from FERC.

The PSC denied the petition for rehearing because, according to the PSC, petitioner did not claim any error of law, as required for rehearing. The PSC found that the TOTS would provide the state with benefits regardless of IPEC retirement, and the benefits would be state-wide, rather than only downstate.

G. Case 14-M-0101, *Proceeding on Motion of the Commission in Regard to Reforming the Energy Vision, Order Instituting Proceeding* (Apr. 25, 2014)

On April 25, 2014, the PSC issued an order instituting a proceeding whose purpose is to "comprehensively consider how our regulatory paradigm and retail and wholesale market designs either effectuate or impede progress toward achieving the policy objectives underlying our system benefit programs and our regulation of electric distribution utilities." The proceeding will look to increase system efficiency, customer choice, and clean generation.

The PSC points out that developments in technology could move the state beyond, what it characterizes as the inefficient model of retaining systems that, aside from the few hours of actual peak demand that occur in a year, are underutilized. In addition, many customers are considering locally generated power to supplement centralized grid power that is susceptible to increasing severe weather events. The PSC is seeking to explore whether the energy system should be revamped to reflect these and other developments.

Based upon a report from DPS Staff, the proceeding will examine:

> [a] new business model for energy service providers in which distributed energy resources (DER) become a primary tool in the planning and operation of electricity systems . . . . [t]he utility functions as a Distributed System Platform Provider (DSPP), actively managing and coordinating distributed resources and providing a market in which customers are able to optimize their priorities while providing, and being compensated for, system benefits.

Track 1 of the inquiry, beginning immediately, will focus on the DSPP issues discussed in DPS Staff's report. Track 2 of the inquiry will focus on regulatory changes and ratemaking issues. For Track 1, a collaborative meeting is set for May 12, 2014, at Empire State Plaza. DPS Staff is expected to distribute a straw proposal on these changes at a July 10, 2014, technical conference, after which, on August 7, 2014, the proposal will be issued for comments due September 8, 2014. For Track 2, party responses to Staff questions must be filed by June 13, 2014, after which a collaborative meeting will be

held on July 21, 2014. A technical conference will be held September 4, 2014; Staff's proposal will be issued October 2, 2014, for comments due November 4, 2014.

3. New York State Board on Electric Generation Siting and the Environment

A. Case 13-F-0287, *Petition of AES Energy Storage, LLC for a Declaratory Ruling that Battery-Based Energy Storage Facilities are not Subject to Article 10 of the PSL, Declaratory Ruling* (Jan. 24, 2014)

On January 24, 2014, the Board declared that stand-alone, battery-based energy storage facilities are not subject to Article 10 of the PSL. Last May, "AES proposed the development of battery-based, energy storage facilities at various sites on Long Island and in the New York City area." AES plans on installing multiple 50 and 100 MW units throughout those areas. Such facilities would store electricity during off-peak hours that could provide capacity, energy, or ancillary services when needed. Importantly, these facilities do not generate any new electricity; thus, the Board ruled that they could not be considered "major electric generating facilities" covered by Article 10. "[N]othing in the statute or its legislative history indicates that the Legislature intended the term 'generation facilities' to have a meaning different from the common understanding of its use," as in a facility that creates or produces electricity, rather than merely stores it.

4. New York State Reliability Council

A. *Installed Reserve Margin for 2014-15 Capability Year*

On December 6, 2013, the NYSRC's Executive Committee adopted its new Installed Reserve Margin ("IRM") for the capability year 2014-15. The IRM was established at 17.0%, which is the same as the 2013-14 IRM. Current and pending environmental initiatives at both the state and federal levels are likely to impact future IRM requirements by leading to plant retirements; however, any possible plant retirements were not expected to affect IRM requirements in 2014.