No. 17-2445 (Consolidated with 17-2433)

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

ELECTRIC POWER SUPPLY ASSOCIATION, *et al.*,

Plaintiffs–Appellants,

v.

ANTHONY M. STAR, *et al.*,

Defendants–Appellees.

On Appeal from a Final Judgment of the United States District Court for the Northern District of Illinois, No. 17 CV 1164

PETITION FOR PANEL REHEARING

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INTRODUCTION

Plaintiffs-Appellants Electric Power Supply Association, et al., respectfully request panel rehearing pursuant to Federal Rule of Appellate Procedure 40.

The panel's factual and legal reasoning follows—and flows from—its misimpression that the district court had "granted summary judgment to the defendants." (Slip op. 3.) Actually, the district court granted *dismissal* of the complaint. (U.S.D.C. ECF 107 ("Dist. Ct. Op.").) The panel's mistake regarding the case's procedural history was substantive, not merely semantic, for instead of "accepting all well-pleaded factual allegations in the complaint as true and drawing all reasonable inferences in favor of the appellants," *Heng v. Heavner, Beyers & Mihlar, LLC*, 849 F.3d 348, 351 (7th Cir. 2017) (citation omitted), the panel instead credited contrary assertions from Exelon and Illinois. In particular, the panel asserts that the Exelon plants may choose to sell their output through bilateral contracts or local distribution companies, despite the complaint's allegation that the plants have no choice but to bid all of their output into the PJM and MISO auctions.

Further, the panel overlooked or misapprehended three key legal arguments under which Appellants would prevail under those well-pleaded allegations. *First*, the panel did not address Appellants' argument that *Wos v. E.M.A.*, 568 U.S. 627 (2013), and other precedent, require the Court to look at the functional operation of the ZEC Program and not just its formal statutory terms.

Second, the panel did not address the argument that the function of the ZEC Program is to ensure that favored nuclear plants receive a per-MWh rate for electricity sold in the wholesale market that is different from (and higher than) the rate approved as reasonable by FERC. Based on these mistakes, the panel held that the ZEC Program survives preemption because (1) it does not expressly require nuclear plants to sell into the PJM and MISO auctions and (2) it does not change the market clearing rate in those auctions any more than permissible state subsidies might.

Finally, the panel misapprehended facts, arguments, and law regarding the Commerce Clause. The slip opinion incorrectly describes the ZEC Program as a "cross-subsidy" among *in-state* generators under which carbon-emitting Illinois generators pay non-emitting Illinois generators. (Slip op. 9.) The panel seemingly misapprehended Appellants' argument to be that they were harmed because they had to pay into this cross-subsidy, for the slip opinion reasons that "[t]he cross-subsidy among producers may injure investors in carbon-releasing plants, but only those plants in Illinois (for the state's regulatory power stops at the border)." (*Id.*) Actually, there is no cross-subsidy; the injury to Appellants is their difficulty competing against Exelon plants, which can dump energy below cost thanks to Illinois's favoritism; and *Alliance for Clean Coal v. Miller*, 44 F.3d 591 (7th Cir. 1995), holds that Illinois cannot distort an interstate market in that manner.

Respectfully, based on these errors, the panel should rehear the case, rule in favor of Appellants, and reverse.

I. The Slip Opinion Misapprehended the Case's Procedural Posture and Key Facts About the ZEC Program's Operation

The slip opinion concludes its recitation of the case's procedural history by stating: "The district judge did not agree with [Appellants' preemption] argument and granted summary judgment to the defendants." (Slip op. 3.) This is indisputably a "point of … fact that … the court has overlooked or misapprehended," sufficient to satisfy Rule 40's standard for rehearing, because the record is clear that the district court granted *dismissal*, not summary judgment. (See Dist. Ct. Op. 2 ("Defendants and Exelon each filed motions to dismiss the complaints. The motions are granted.").)

In an appeal from a motion to dismiss, this Court must take "all well-pleaded factual allegations in the complaint as true and draw[] all reasonable inferences in favor of the appellants." *Heng,* 849 F.3d at 351. The slip opinion makes no mention of this standard of review. Had the Court not misapprehended the case's procedural posture, it would have accepted as true the complaint's factual allegations,[1] which are certainly well-pleaded.

But the panel did not do so. Based either on misapprehending the case's procedural posture or overlooking the complaint's well-pleaded allegations, the panel instead took as true assertions made by Exelon and Illinois that were inconsistent with the complaint. Further, the panel reasoned based on an account of the ZEC Program that is incorrect.

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[1] To be clear, Appellants submit that the complaint's allegations *are* true and that Defendants' contrary assertions are wrong. But at this procedural stage, this Court need not (and cannot) resolve such disputes; instead, the Court takes the complaint as true and draws all inference in Appellants' favor.

The most material discrepancy between the slip opinion and the complaint concerns how Exelon's nuclear plants sell the electricity they generate. The complaint alleges that these plants have no choice but to bid all the electricity they generate into the PJM and MISO auctions. (App. 5, 15-17, 25-26, 29-30, 32 (Compl. ¶¶ 10, 36, 38, 54, 55, 56, 64, 66, 72).) And, indeed, the district court recognized that "in practice," the ZEC Program had "the effect of conditioning payment on clearing the wholesale auction." (Dist. Ct. Op. 32.) Notwithstanding these allegations, the slip opinion accepted Defendants' assertion that Exelon's plants "may choose instead to sell power through bilateral contracts with users (such as industrial plants) or local distribution companies that transmit the power to residences."[2] (Slip op. 6.) Unless this is just an assertion about the literal text of the ZEC Program and

[2] Even if this assertion were true (which it is not) and even if the Court could disregard the complaint's contrary well-pleaded allegations (which it cannot), the point should be immaterial. The rate set in a bilateral contract for wholesale electricity is itself a FERC-approved rate. *See, e.g.*, *Morgan Stanley Capital Group Inc. v. Public Util. Dist. No. 1 of Snohomish Cty.*, 554 U.S. 527, 546-48 (2008). If Illinois displaced such a rate, negotiated at arm's length, with the inflated ZEC rate, it would intrude on FERC's exclusive jurisdiction just as it does when it displaces the auction rate.

not its actual operation (*see infra*), the panel's reasoning violates the requirement of accepting as true the complaint's allegations.

The slip opinion makes a number of additional mistakes in describing the ZEC Program. Two warrant particular mention.

First, the slip opinion incorrectly states that "[g]enerators that use coal or gas to produce power must purchase these [ZEC] credits from the recipients at a price set by the state" and that ZECs "rais[e] the costs that carbon-releasing producers incur to do business." (Slip op. 2, 6; *see also* Slip op. 9 ("All carbon-emitting plants in Illinois need to buy [ZEC] credits.").) This is incorrect. As explained in Appellants' Opening Brief (10), it is not generators but "load serving entities" (LSEs)—entities that purchase power at wholesale and sell it at retail to end-use consumers—that make the ZEC subsidy payments, passing those costs along to end consumers (App. 5-6, 20-21 (Compl. ¶¶ 10-11, 46)).

Any suggestion that Illinois has implemented a "cap and trade" based carbon market completely misapprehends the nature of the state's actions. The harm to disfavored generators is not that they need to buy ZECs (none of them do) but that they need to compete against

Exelon's favored plants, which can dump their electricity at a $0 bid in the PJM and MISO auctions, knowing that irrespective of the market-clearing price, they will receive a subsidized rate that was specifically set to ensure they would be profitable enough to stay in business. (App. 26 (Compl. ¶ 58).)

Second, the slip opinion incorrectly states that when one of Exelon's favored plants successfully bids into the PJM and MISO auctions, it "receives th[e] market-clearing price, with none of the adjustments that Maryland [at issue in *Hughes*] law required." (Slip op. 6.) But that is not so. The favored plants do *not* "receive[] th[e] market-clearing price"; if that were so, they would go out of business. As pleaded by the complaint, and as acknowledged by the district court, "Illinois created a 'zero emission credit' program to effectively subsidize nuclear power generation and *corresponding sales of nuclear power in the wholesale market*." (Dist. Ct. Op. 1, emphasis added.) Thus, the ZEC Program "effectively replac[es] the auction clearing price … with the alternative, higher price preferred by the Illinois General Assembly." (*Id.* 10.)

Appellants respectfully submit that, without these factual misapprehensions, the slip opinion's reasoning cannot stand.

II. The Slip Opinion Overlooked the Functional Test for Preemption

Appellants explained in their Opening Brief (45-51) and Reply Brief (32-37) that preemption analysis does not stop at the literal terms of the state law (*i.e.* "semantics"), but also considers the law's functional effect (*i.e.*, "what the state law in fact does"). *See Wos*, 568 U.S. at 636-37; *Nat'l Meat Ass'n v. Harris*, 565 U.S. 452, 462-64 (2012). A state law artfully drafted to avoid directly regulating "the prices of interstate wholesales" is still preempted if it "indirectly achieve[s] the same result." *Northern Natural Gas Co. v. State Corporation Commission of Kansas*, 372 U.S. 84, 90-91 (1963). Indeed, as noted in Appellants' Response to FERC's amicus brief (6-10), the Solicitor General expounded exactly that position in opposing certiorari in *Virginia Uranium*. In the merits briefing in that case, the Solicitor General similarly explained that "a State cannot escape preemption simply by regulating a stage of the production process or stream of commerce that lies outside the area of direct federal regulation" and that the "inevitable effect" of the state law was itself a basis for preemption.

(*See* Brief for the United States as Amicus Curiae Supporting Petitioners at 27-30, *Virginia Uranium, Inc. v. Warren*, No. 16-1275, 2018 WL 3599466 (analyzing, *inter alia*, *Nat'l Meat Ass'n*).)

The slip opinion overlooks *Wos*, *National Meat Association*, and the other similar cases cited by Appellants (and the Solicitor General), and addresses only the question whether the express terms of the Illinois law run afoul of *Hughes*. (Slip op. 6.) But here, "what the state law in fact does," *Wos*, 568 U.S. at 637, is—as even the district court conceded—to "effectively replac[e] the auction clearing price … with the alternative, higher price preferred by the Illinois General Assembly." (Dist. Ct. Op. 10.) Thus, under a functional rather purely "semantic" approach, the ZEC Program should be preempted.

III. The Slip Opinion Misapprehended Appellants' Rate-Setting Argument

The slip opinion asserts that Appellants "insist" that "the zero-emission-credit system … indirectly regulates *the auction* by using average auction prices as a component in a formula that affects the cost of a credit" (Slip op. 3, emphasis added), a position the panel rejects because "[t]he zero-emissions credit system can influence the auction price only indirectly, by keeping active a generation facility that otherwise might close and by raising the costs that carbon-releasing producers incur to do business" (*id.* 6).

This is both factually wrong (as noted above, carbon-emitting suppliers are never required to purchase ZECs) and overlooks Appellants' core preemption argument, which argues not primarily that Illinois is regulating *the auction* for all participants, but rather that Illinois is replacing the auction-based rate with its own rate for the favored nuclear plants.

Before the district court, Appellants "argue[d] that the ZEC program invades FERC's field of exclusive jurisdiction because it provides nuclear plants with substantial out-of-market payments, thereby directly affecting the revenue that nuclear generators will be paid and effectively replacing the auction clearing price." (Dist. Ct. Op. 33.) Appellants likewise argued to this Court the ZEC "program invades FERC's exclusive jurisdiction because it replaces the FERC-determined just and reasonable prices for wholesale electricity with a different rate determined by the State."[3] (Opening Brief) 3; *see id.* 39-

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[3] Indeed, the section heading of the first substantive preemption section is "The ZEC Program Is Preempted Because It Intrudes upon an Exclusively Federal Field of Law by Ensuring that Certain Favored

59.) Despite this being Appellants' lead argument, the slip opinion does not seem to address it. Instead, it addresses only the "indirect[]" effect on the auction as a whole, which it deems no greater than the effect of permissible subsidies. (Slip op. 3, 6.)

Whatever indirect effect the ZEC Program may have on the market-clearing price, it has a *direct* effect on the rates received by the favored Exelon plants. In the words of the statute, Illinois has set the "rates and charges … received [by Exelon] … in connection with" its sales of wholesale electricity, by dictating that Exelon will receive a subsidy over and above the FERC-approved auction rates, just as Maryland impermissibly did in *Hughes*. 16 U.S.C. § 824d(a). As the district court recognized, the ZEC Program "effectively replac[es] the auction clearing price received by these plants with the alternative, higher price preferred by the Illinois General Assembly." (Dist. Ct. Op. 10.) Incidentally, assuming counterfactually that Exelon's plants were selling via direct bilateral contracts, those arm's-length, FERC-

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Power Generators Receive Payments in Connection with Their Wholesale Electricity Sales Over and Above the Rates that FERC Has Determined Are Just and Reasonable." (Opening Brief 39.)

approved rates would *also* be replaced "with the alternative, higher price preferred by the Illinois General Assembly." (*Ibid*; *see supra* n. 2.)

For every MWh that its favored plants sell at wholesale, Exelon receives not the rate that FERC deemed just and reasonable, but the higher rate that Illinois deemed necessary to keep Exelon's plants in business. This feature—replacing the FERC rate, and doing so by means of a subsidy tethered to the wholesale market price—distinguishes the ZEC program from permissible alternatives such as direct subsidies or land grants. Illinois decided that if Exelon received the rate set by FERC, its plants would fail, and therefore set a different rate for Exelon's plants. That is just what *Hughes* forbids.

IV. The Slip Opinion's Commerce Clause Analysis Misapprehended How the ZEC Program Operates and What Appellants Argued, and It Overlooked *Alliance for Clean Coal*

As noted above with respect to the slip opinion's mistakes of fact, the Commerce Clause analysis rests on a basic misunderstanding of how the ZEC program works. The slip opinion describes the ZEC program as a "cross-subsidy among producers" in which "carbon-emitting plants in Illinois need to buy credits" from favored "carbon-free generat[ors]." (Slip op. 9.) This is mistaken: the ZEC credits are bought not by carbon-emitting plants but by LSEs (*i.e.*, utilities). (*See supra* p. ___.) From that mistake, the slip opinion reasons that "[t]he cross-subsidy among producers may injure investors in carbon-releasing plants, but only those plants in Illinois (for the state's regulatory power stops at the border)." (Slip op. 9.) This is doubly wrong—there is no cross-subsidy, and the injury caused by the ZEC Program extends beyond Illinois's border *by design*.

The PJM and MISO auctions are interstate markets in which in-state generators compete both among themselves and against out-of-state generators (like Appellants). Exelon's favored plants are in-state Illinois generators. They cannot compete fairly against the out-of-state generators like Appellants' plants because Exelon's plants are so inefficient and costly that if they sell at profit (or even at cost), no one will buy their energy, and if they sell at a price LSEs will pay, the plants will go out of business. As the district court explained, Illinois could not abide a situation in which out-of-state generators drove the Exelon plants out of business because this might cause the loss of in-state jobs and in-state economic activity. (Dist. Ct. Op. 6.) The governor expressly stated that the purpose of the ZEC Program was to protect "the good-paying jobs at the Clinton and Quad Cities' plants." (*Id.* 7.)

Illinois jobs are saved only when Illinois plants win out against non-Illinois plants like Appellants'. But, as this Court has already told Illinois in *Alliance for Clean Coal*, the State cannot prop up in-state companies by "'neutralizing the advantage possessed by lower cost out of state producers.'" 44 F.3d at 595. As set forth in Appellants' Opening Brief (62-70) and Reply Brief (49-57), Illinois cannot use its regulatory powers to tilt an interstate market in favor of in-state companies.

The slip opinion implies that Section 824(b)(1) displaces traditional Commerce Clause analysis here because the ZEC Program is "a cross-subsidy" among in-state generators, such that an in-state bias "is required by the rule that a state must regulate within its borders." (Slip op. 9.) The premise of this reasoning is mistaken, as explained above. In reality, nothing in Section 824(b)(1) would prevent Illinois from opening the ZEC Program to out-of-state non-carbon-emitting generators.

Once the misapprehensions of how the ZEC Program works and what Appellants are arguing are removed, Appellants submit—as they did in their Opening Brief (60, 64-65, 70) and Reply Brief (48, 51, 53)—that *Alliance for Clean Coal* forecloses the argument that subsidies that state regulations favoring in-state business can escape Commerce Clause scrutiny simply because it concerns electrical generation.

In response to the Commerce Clause challenge in *Alliance for Clean Coal*, "Illinois argue[d] that it ha[d] merely 'agreed to "subsidize" the cost of generating electricity through the use of Illinois coal by requiring its own citizens to bear the cost of pollution control devices.'" 44 F.3d at 596. This Court rejected that argument because "the fact that Illinois rate-payers are footing the bill does not cure the discriminatory impact on western coal producers. As the Supreme Court noted in rejecting an identical argument in *West Lynn*, '[t]he cost of a tariff is also borne primarily by local consumers yet a tariff is the paradigmatic Commerce Clause violation.'" *Id.* (quoting *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 203 (1994).)

Illinois also argued that it was "protecting Illinois and its citizens from economic harm that would result from a decline in the local coal industry." *Id.* The Court rejected that argument as well, because "[s]uch concerns do not justify discrimination against out-of-state producers. 'Preservation of local industry by protecting it from the rigors of interstate competition is the hallmark of economic protection that the Commerce Clause prohibits.'" *Id.* (quoting *W. Lynn Creamery*, 512 U.S. at 205.)

Respectfully, based on correct facts and controlling law, Section 824(b)(1) cannot be deemed to permit a State to subsidize in-state generators so that they can dump their energy below cost and thereby undercut out-of-state generators.

CONCLUSION

The panel should grant this petition and reverse the district court.

CERTIFICATE OF COMPLIANCE

1. This brief complies with the word limit set by Fed. R. App. P. 40(b) because, excluding the parts of the document exempted by Fed. R. App. P. 32(f), this document contains 3,043 words, as determined by Microsoft Word 2010.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because this document has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Century Schoolbook font.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on September 27, 2018, I caused the foregoing to be filed electronically with the Clerk of the Court using the CM/ECF system, which will send a Notice of Electronic Filing to all counsel of record.

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