FERC v. Electric Power Supply Association, No. 14-840; EnerNOC, Inc. v. Electric Power Supply Association, No. 14-841

The Federal Power Act (FPA) grants the Federal Energy Regulatory Commission exclusive jurisdiction over "the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b)(1). FERC may regulate any "rule, regulation, practice, or contract affecting [a wholesale] rate." *Id.* § 824e(a). But only states may regulate "any other sale of electric energy"—namely retail sales to consumers. *Id.* § 824(b)(1). The wholesale and retail markets are obviously interconnected; each inexorably affects the other, and the boundaries are not always clear. Today, in *FERC v. Electric Power Supply*, No. 14-840, and *EnerNOC, Inc. v. Electric Power Supply Association*, No. 14-841, the Court rejected a firm division between state and federal authority, concluding that FERC's Order 745 was valid even though it resulted in payments to retail customers based on changes in their retail power consumption.

FERC adopted Order 745 addressing "demand response," an innovation in energy markets that manages prices during periods of high demand by providing incentives to consumers to reduce consumption. Demand response mechanisms may either raise energy prices or compensate consumers for reduced energy consumption during peak periods. Recognizing that direct retail price regulation would exceed its authority, FERC addressed only consumer compensation. Order 745 requires wholesale electricity market operators to compensate consumers who reduce consumption at the same rate paid to traditional electricity generators; the order also allocates the cost of this compensation among wholesale-market energy purchasers. The order allows states to prohibit their consumers from bidding for demand-response payments, however. During the rulemaking process, the respondents (electricity generators and their trade associations) opposed the proposed Order 745 as beyond FERC's authority and as substantively unsound. When Order 745 was promulgated, respondents petitioned for review to the D.C. Circuit. A divided court of appeals vacated the order as *ultra vires* and as arbitrary and capricious in its choice of compensation mechanism.

The Supreme Court reversed the D.C. Circuit and upheld Order 745, concluding (1) that FERC reasonably concluded that it has authority under the Federal Power Act to regulate wholesale market operators' compensation of demand-response suppliers and (2) that Order 745 is not arbitrary and capricious. In her opinion for the Court, Justice Kagan reasoned that Order 745 "complies with the [Federal Power Act's] plain terms" based on a two-step analysis. First, "the practices at issue in [Order 745]—market operators' payments for demand response commitments—directly affect wholesale rates." The presence of some effect was undeniable but not controlling; a direct effect was necessary, and resulted from the downward pressure on prices exerted by demand-response payments that were at a lower rate than the next available supply source and that also relieved system loads. Second, the Court concluded, FERC "has not regulated retail sales." The Court was not swayed Order 745's requirement of direct payments to large retail consumers (as well as aggregations of retail consumers) for forgoing electricity consumption. In the Court's view, so long as "FERC regulates what takes place on the wholesale market, as part of carrying out its charge to improve how that market runs, then no matter the effect on retail rates," the FPA imposes no bar. The Court also examined the effect of a more formal division of authority on the purposes of the FPA, which was enacted to fill the regulatory gap resulting from the states' inability to regulate outside their respective territories. The states clearly could not require demand-response payments in wholesale markets that only FERC could regulate. Construing the FPA to withhold the same authority from FERC "would conflict with the [Federal Power] Act's core purposes by preventing all use of a tool that no one … disputes will curb prices and enhance reliability in the wholesale electricity market." Finally, the majority determined that FERC's decision to compensate demand-response providers at the same price paid to generators was not arbitrary and capricious. The Court's "important but limited role is to ensure that [FERC] engaged in reasoned decisionmaking," which the Court defined to include "that it weighed competing views, selected a compensation formula with adequate support in the record, and intelligibly explained the reasons for making that choice." FERC satisfied this standard by taking "full account of the alternative policies proposed" and adequately supporting and explaining its decision, among other things through an affidavit by leading regulatory economist Alfred Kahn.

Justice Scalia dissented, joined by Justice Thomas. (Justice Alito was recused.) In the dissenters' view, the Federal Power Act "prohibits [FERC] from regulating the demand response of retail purchasers of power" because those transactions did not fall within the statutory definition of a "sale … at wholesale" as a "sale … for resale," 16 U.S.C. § 824(d). Believing that the majority had applied a presumption in favor of jurisdiction, the dissent argued for the opposite presumption, concluding that the demand-response transactions were not "demonstrably sales at wholesale" because the demand-response bidders did "not resell energy to other consumers." The dissent also contended that Order 745 does in fact regulate retail sales because the effect of the demand-response payment increases the price to any consumer who forgoes that payment and instead consumes electricity.

The Court's decision reflects a willingness to find broad federal agency jurisdiction when regulated conduct arguably falls into a gray area, at least when the regulatory scheme at issue is well-established and of broad scope. The Court's decision appeared to be entirely policy-driven; the only explicit analysis of the statutory definition of the statutory grant of power came in the

dissent. In addition, to the extent the Court inferred a grant of power from the fact that a desirable regulatory initiative otherwise might be impossible, the Court's reasoning may affect future challenges to assertions of regulatory authority.

Any questions regarding this case should be directed to Donald M. Falk (+1 650 331 2030) in our Palo Alto office.