

A POWER STRUGGLE: DEMAND RESPONSE AND THE LIMITS OF FERC'S AUTHORITY

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ADDENDUM

This Commentary was written prior to the Supreme Court's decision on January 25, 2016. In our Commentary, we distilled the Supreme Court's decision to a choice between two general holdings: (1) FERC cannot regulate the retail market, and any regulation of demand response amounts to exactly that; or (2) the agency has authority to impact behavior in the retail market, so long as it acts within the wholesale market. As we expected, the Supreme Court held (6-2) in favor of the latter, upholding FERC's jurisdiction over wholesale demand response, regardless of any incidental impact on the retail market.¹

The Court considered two issues: whether FERC was authorized to regulate demand response at all, and whether the order was arbitrary and capricious. On the latter issue, the court merely exercises deference to FERC's rate-setting power; it refuses to reconsider FERC's conclusion.² The jurisdictional question offers a more interesting analysis. The majority opinion reaches the conclusion that FERC had authority to act in three steps.

First, the Court confirms the expansive effect of § 206 on FERC's jurisdiction. As we discuss in Section II-C of our Commentary, § 206 expands FERC's jurisdiction because the language "practices . . . affecting [wholesale] rates" is necessarily broader than "wholesale

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1. See *FERC v. Electric Power Supply Ass'n.*, 577 U. S. ___, 33-34 (2016) ("FERC's statutory authority extends to the Rule at issue here addressing wholesale demand response And although (inevitably) influencing the retail market too, the Rule does not intrude on the States' power to regulate retail sales.").

2. See *id.* at 30 ("Our important but limited role is to ensure that the Commission engaged in reasoned decisionmaking FERC satisfied that standard.").

rates” alone.³ The Court now adopts the “common-sense” limitation that FERC’s “affecting” jurisdiction is limited to rules or practices that “*directly* affect the [whole-sale] rate,” but this statutory interpretation provides enough room for FERC to issue Order 745 because wholesale demand response “is all about reducing wholesale rates.”⁴

Interestingly, the majority sidesteps the issue of how much deference should be afforded to agencies in interpreting their own jurisdiction.⁵ In our analysis, we anticipated the jurisdictional deference question to be more significant, but the Court instead holds that the FPA unambiguously grants authority to FERC.⁶

Second, the Court addresses the federalist claim that any jurisdiction FERC may have is ultimately limited by the States’ exclusive authority to regulate retail sales. The majority agrees that the FPA does reserve some exclusive authority for States.⁷ Where, however, FERC “affects” retail sales through its oversight of wholesale transactions, it has not intruded State authority.⁸

The Court characterizes wholesale demand response as “a practice directly affecting wholesale electricity rates,” which “(inevitably) influenc[es] the retail market too.”⁹ Although it does not say so explicitly, the Court’s understanding of demand response aligns with FERC’s.¹⁰ The Court’s adoption of FERC’s view is directly opposed to the D.C. Circuit’s derision of FERC’s characterizations as

3. *See Fed. Power Comm’n v. Conway Corp.*, 426 U.S. 271, 281–82 (1976) (“The rules, practices, or contracts ‘affecting’ the jurisdictional rate are not themselves limited to the jurisdictional context.”).

4. *Electric Power Supply Ass’n.*, 577 U. S. ___ at 15 (quoting *California Independent System Operator Corp. v. FERC*, 372 F. 3d 395, 403 (D.C. Cir. 2004)).

5. *See id.* at 14 n.5 (“Because we think FERC’s authority clear, we need not address the Government’s alternative contention that FERC’s interpretation of the statute is entitled to deference.”).

6. *Id.*

7. *See id.* at 17–18 (explaining that were FERC to issue an order that “specifies terms of sale at retail,” then “the regulation would exceed FERC’s authority” since regulation of retail sales “is a job for the States alone”).

8. *See id.* at 18 (“Yet a FERC regulation does not run afoul of §824(b)’s proscription just because it affects—even substantially—the quantity or terms of retail sales.”).

9. *Id.* at 34.

10. *See Electric Power Supply Ass’n.*, 577 U. S. ____ at 17 (“Compensation for demand response thus directly affects wholesale prices. Indeed, it is hard to think of a practice that does so more.”)

“creative” and “metaphysical.”¹¹ It is unclear the extent to which the Court is agreeing with FERC or deferring to its expertise.

Finally, the Court adds that FPA’s purpose is to “eliminate vacuums of authority over the electricity markets.”¹² If FERC has no authority over wholesale demand response, then no one would, creating exactly to sort of vacuum the FPA was intended to eliminate.¹³

The Court concludes that the FPA was intended to close regulatory vacuums by drawing from legislative history. As we discuss in Section II-A of our Commentary, the Act was passed to close the *Attleboro* Gap. The Court refuses to accept that Congress would intend the reservation of State authority to create a new gap in demand response.

Overall, the Court held that both the plain text and legislative purpose of the FPA unambiguously grant FERC the authority it needs to regulate wholesale demand response. Deference did not play as large a role in determining the jurisdiction question as we anticipated, although it is unclear whether it might have were the Court’s view not in line with FERC’s. The opinion is significant for its broad delineation of federal regulatory authority in the energy industry rather than for any clarification on how much deference to afford regulatory agencies in determining their own jurisdiction.

INTRODUCTION

In the consolidated case of *FERC v. Electric Power Supply Ass’n* and *EnerNOC v. Electric Power Supply Ass’n*,¹⁴ the Supreme Court will decide whether the Federal Energy Regulatory Commission (FERC) has the authority to regulate the developing demand response market. The case raises two core issues: (1) what is the reach of FERC’s jurisdiction, particularly as it relates to traditional state authority over the retail energy market, and (2) to what extent is demand response a fiction used to create a loophole through which FERC can regulate the price of electricity paid by consumers? The

11. See *Electric Power Supply Ass’n v. FERC*, 753 F.3d 216, 221, 223 (D.C. Cir. 2014) (explaining that FERC’s distinction between wholesale and retail demand response was “metaphysical” and jurisdictional bounds cannot be circumvented through FERC’s “creative characterizations”).

12. See *Electric Power Supply Ass’n*, 577 U. S. ____ at 2–3 (discussing the *Attleboro* Gap).

13. *Id.*

14. 135 S. Ct. 2049 (2015).

Supreme Court will make one of two possible determinations. The first possibility is that the Court will agree with the D.C. Circuit Court of Appeals and the Electric Power Supply Association (EPSA) that FERC cannot regulate the retail market, and any regulation of demand response amounts to exactly that. The second possibility is that the Court will agree with FERC and EnerNOC that the agency indeed has authority to incentivize behavior in the retail market so long as it acts within the wholesale market, which the regulation is specifically tailored to do. The argument explicated in what follows is that the Court should overturn the D.C. Circuit and defer to the agency's characterization of demand response, thereby placing wholesale demand response resources under FERC's jurisdiction.

I. FACTS

FERC's Order 745 focuses on "demand response resources"—i.e. entities "capable of providing demand response"¹⁵—that are customers in wholesale energy markets or aggregators of retail customers.¹⁶ "Demand Response" is defined as a "reduction in the consumption of electric energy by customers from their expected consumption in response to an increase in the price of electric energy or to incentive payments designed to induce lower consumption of electric energy."¹⁷

On March 15, 2011 FERC issued Order 745, titled "Demand Response Compensation in Organized Wholesale Energy Markets."¹⁸ Order 745 requires the institutions that administrator regional energy markets—known as Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs) (hereinafter collectively encompassed within the term RTO) and described in greater detail below—to compensate "demand response resources . . . at the market price for energy" as an alternative to generation of additional electricity "when dispatch of that demand response resource is cost-effective."¹⁹ In other words, Order 745 is designed to make RTOs buy

15. 18 C.F.R. § 35.28(b)(5) (2015).

16. Demand Response Comp. in Organized Wholesale Energy Markets, 134 FERC ¶ 61187, 2011 WL 890975 at *3 [hereinafter Order 745].

17. 18 C.F.R. § 35.28(b)(4) (2015).

18. Order 745, *supra* note 3.

19. *Id.* at *1.

energy back from the market rather than pay for new energy when generating new energy would be inefficient.

A. *An Overview of the Energy Market*

Energy markets used to be dominated by local monopolies that generated, transmitted, and delivered energy directly to consumers within state lines. The modern market is largely divided into specialist entities that cross state borders, responsible for generation, transmission, or distribution.²⁰ Today, electricity most frequently reaches consumers through an interstate “grid,” which allows the industry to pool the electricity regionally and transmit it over long distances.²¹

Most electricity served to U.S. consumers originates as a transmission in the “wholesale market” from a power generator to a local distributor through a RTO.²² RTOs facilitate open access to transmission throughout the grid.²³ The generators put electricity up for sale, the distributors bid for it, and the RTO facilitates “nondiscriminatory open-access” transmission to allow for competitive, unimpeded power markets.²⁴ The final “retail market” transaction takes place between the local distributor and the retail customer.²⁵

B. *FERC Sees a Market Failure in the Form of Inelastic Demand for Electricity*

Unlike most commodities, electricity on the energy grid is not stored for later use; it is used and produced contemporaneously.²⁶ To

20. See *New York v. FERC*, 535 U.S. 1, 6–7 (2002); OFFICE OF ENFORCEMENT, FEDERAL ENERGY REGULATORY COMMISSION, ENERGY PRIMER: A HANDBOOK OF ENERGY MARKET BASICS 41 (2015) [hereinafter “Energy Primer”].

21. See *New York*, 535 U.S. at 7.

22. See Energy Primer, *supra* note 7, at 40 (“[T]wo-thirds of the nation’s electricity load is served in RTO regions.”).

23. *Id.*

24. *Id.*; see also *New York*, 535 U.S. at 10 (explaining that FERC’s rule would provide for “nondiscriminatory open-access transmission services” to encourage competitively priced electricity).

25. See Energy Primer, *supra* note 7, at 27.

26. See Brief of Private Petitioners at 7, *EnerNOC, Inc. v. Elec. Power Supply Ass’n*, Nos. 14-840, 841 (U.S. July 9, 2015) [hereinafter Brief of Private Petitioners] (“Electricity cannot currently be cost-effectively stored for later use in significant quantities.”); Brief for the Petitioner at 8, *FERC v. Elec. Power Supply Ass’n*, No. 14-840 (U.S. July 9, 2015) [hereinafter Brief for the Petitioner] (“[E]lectricity generally cannot be stored.”); see also *Elec. Power Supply Ass’n v. FERC*, 753 F.3d 216, 228 (D.C. Cir. 2014) *cert. granted in part*, 135 S. Ct. 2049,

avoid waste or lack of supply, electricity production—i.e. supply from electricity generators—must be constantly adjusted to track demand.²⁷

Electricity use, however, is variable. Use tends to spike at certain times of the day or in response to various circumstances, such as a heat wave that causes consumers to switch on air conditioners en masse.²⁸ During these periods of spiked demand for electricity, supply needs to be supplemented. Generators must turn on additional power sources, and the supplemental electricity often must originate from the more costly sources of power, which are turned on only when other, more efficient sources are at full-capacity.²⁹ The cost of producing electricity typically spikes along with demand, but consumers are often cushioned from fluctuations in cost by state agencies that set a single retail price for electricity over a longer period, regardless of cost fluctuations.³⁰ Higher prices, therefore, do not influence demand for electricity, so consumers will frequently consume electricity even when the costs to produce the electricity are higher than the value to the consumer.³¹

Distributors will demand electricity in the wholesale market at whatever quantity its retail customers demand, regardless of price. Thus, demand in the wholesale market is likewise uncoupled from the cost of supplying electricity.³²

Consequently, in the U.S., “[e]lectricity demand (overall) is generally inelastic to price.”³³ As the cost of generating electricity

191 L. Ed. 2d 954 (2015) and cert. granted in part sub nom. *EnerNOC, Inc. v. Elec. Power Supply Ass’n*, 135 S. Ct. 2049, 191 L. Ed. 2d 954 (2015) (Edwards, J., dissenting).

27. See *Elec. Power Supply Ass’n*, 753 F.3d at 228 (Edwards, J., dissenting) (“[E]lectricity, unlike most commodities, cannot be stored for later use. There must instead be a continual, contemporaneous matching of supply to meet current electricity demand.”).

28. See Energy Primer, *supra* note 7, at 41.

29. See *Elec. Power Supply Ass’n*, 753 F.3d at 228 (Edwards, J., dissenting) (“[A]t hours of peak usage (e.g., a summer afternoon in Washington, D.C. when countless air conditioners toil against the humidity and heat), the suppliers of electricity must marshal the least efficient and most costly power plants to match the soaring demand for electricity.”).

30. See Energy Primer, *supra* note 7, at 43–44 (explaining that “[s]tate regulatory agencies set prices and policies affecting retail customer service” and “most end use consumers are not exposed to real-time electricity prices”); see also *Elec. Power Supply Ass’n*, 753 F.3d at 228 (Edwards, J., dissenting) (“Retail electricity prices are generally regulated to remain constant over longer periods of time. That is, consumers do not pay different amounts during different hours of the day, notwithstanding the sharply vacillating cost of producing electricity.”).

31. See *Electric Power Supply Ass’n*, 753 F.3d at 228 (Edwards, J., dissenting) (noting that retail demand is not price responsive).

32. See *id.*

33. See Energy Primer, *supra* note 7, at 44; see also Order 745, *supra* note 3, at 45. (“[D]emand responsiveness to price changes is relatively inelastic in the electric industry and

increases and drives up the price of electricity, demand in the retail market is unaffected. Retail consumers never notice the peaks in price of electricity generation and therefore have no incentive to reduce consumption. Thus, the price of electricity remains artificially elevated for all consumers over the long run.³⁴

FERC found that the uncoupling of price and demand is a systematic market problem because, without normal interaction between price and consumption, the energy market suffers from inefficient and artificially high prices.³⁵ FERC concluded that demand must have some impact on the market for prices to be “just and reasonable in the organized wholesale energy markets.”³⁶

C. FERC Sees Wholesale Demand Response as a Solution to the Market Failure

To rectify the problem, FERC decided to encourage the market for demand response resources.³⁷ FERC determined that wholesale demand response can balance supply and demand just as freely fluctuating prices might in an effective retail market.³⁸

In effect, federal policymakers recognized two possible methods for demand to play its proper part in adjusting consumption: freely fluctuating prices that force consumers to adjust their consumption or else suffer higher prices, or payments to consumers that offer a “carrot” to incentivize reduced consumption at peak times.³⁹ By paying consumers to decrease energy use, electricity markets can be stabilized through “voluntary” reductions.⁴⁰ Rather than offer

does not play as significant a role in setting the wholesale energy market price.”).

34. *See id.*

35. *See Order 745, supra* note 3, at *1 (arguing that “a market functions effectively only when both supply and demand can meaningfully participate,” and determining that once demand is factored into the market, customers will benefit from reduced prices).

36. *Id.* at *3.

37. *See id.* at *2 (“We conclude that when a demand response resource participating in an organized wholesale energy market administered by an RTO or ISO has the capability to balance supply and demand.”).

38. *See id.* at *7 (“[A]ctive participation by customers in the form of demand response in organized wholesale energy markets helps to increase competition in those markets.”).

39. *Id.*

40. Note that the term “voluntary” used in this context is controversial. FERC contests consumers “voluntarily” decrease demand to obtain payments, while critics contest that retail customers are “drawn into” the demand response market by incentives, such that their decision is not “voluntary” in the strictest sense of the word. *See Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216, 220 (D.C. Cir. 2014) (“FERC claims when retail consumers voluntarily participate in the wholesale market, they fall within the Commission’s exclusive jurisdiction to make rules for that market The problem, Petitioners say, is the Commission has no authority to draw retail

consumers subsidies directly, however, FERC decided to focus its efforts on wholesale markets.⁴¹

While states and utilities have started addressing the problem of price inelasticity directly in the retail market, FERC decided it could supplement these efforts by setting a rate at which RTOs would pay for demand response resources in the *wholesale* markets.⁴² To date, several demand response resources have entered into wholesale markets, typically as a means to improve grid reliability by providing the RTO a quick means to curtail energy usage if power supply is insufficient.⁴³ Wholesale demand response resources are typically third-party aggregators who buy commitments to refrain from energy use from consumers when called upon; aggregators then resell those commitments to RTOs in wholesale energy markets.⁴⁴ Retail demand response, by contrast, consists of direct subsidies to effectively change the *retail* price of energy paid by consumers.⁴⁵

Until Order 745, RTOs paid wholesale demand response resources variable amounts and developed their own compensation methodologies.⁴⁶ FERC recognized, however, that setting a stable and uniform price for wholesale demand response could foster a more stable and vibrant market for demand response.⁴⁷ Rather than make up an arbitrary price for demand response, FERC pegged demand response to the “locational marginal price” (LMP) of electricity, which is—as its name suggests—the cost of producing an additional unit of electricity within a given region.⁴⁸ FERC determined that encouraging the demand response market would give RTOs an alternative to

customers into the wholesale markets by paying them not to make retail purchases.”).

41. Order 745, *supra* note 7 at *3.

42. *See id.* (“[A] number of states and utilities are pursuing retail-level price-responsive demand initiatives Our focus here is on customers or aggregators of retail customers providing, through bids or self-schedules, demand response that acts as a resource in organized wholesale energy markets.”).

43. *Id.* at *11. *See also* Energy Primer, *supra* note 7 at 45–46 (“Some RTOs permit DRR to participate in their markets as voluntary reliability resources. DRR also can participate in wholesale electricity markets as capacity resources and receive advance reservation payments in return for their commitment to participate when called.”).

44. Energy Primer, *supra* note 7, at 46.

45. *See* Brief of Petitioner, *supra* note 26, at 28 (“[I]n a retail-level demand-response program, the compensation to retail users is not funded by adjusting wholesale rates charged in day-ahead and real-time markets, and the demand-response commitments are not selected based on their ability to clear the wholesale market. Rather, the demand response payments are recouped through adjustments to retail rates (potentially over the long term).”).

46. Order 745, *supra* note 3 at *11.

47. *Id.* at *2–3.

48. *Id.*

generation of additional power when they require additional capacity and thereby provide for an efficient energy market with just prices.⁴⁹ In addition, FERC added the caveat that the price should only be fixed when cost effective because paying for non-use of electricity sometimes leads to *higher* prices by undermining efficiencies of scale.⁵⁰

D. Procedural History

EPSA and four other energy industry associations challenged Order 745 by petitioning for judicial review by the D.C. Circuit of Appeals.⁵¹ The D.C. Circuit held that FERC's action was *ultra vires* and vacated the rule in its entirety.⁵² The Supreme Court granted petitions for writ of certiorari from both FERC and EnerNOC and consolidated the proceedings.⁵³ Justice Alito recused himself from the case.⁵⁴

II. LEGAL BACKGROUND

A. FERC's Jurisdiction in Historical Context

The jurisdiction of FERC was initially tailored "to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce."⁵⁵

Before FERC was established, electricity was largely produced, transported and supplied to consumers locally.⁵⁶ Utilities were subject to state or local regulation.⁵⁷ By 1927, however, the nature of the energy industry had changed.⁵⁸ Instead of one local utility engaged in producing and delivering power, the market had fractured so that a power producer might operate the local power plant, while a separate

49. *Id.*

50. *See id.* at *3 (explaining that wholesale consumers pay for electricity at a price per megawatt that decreases as the load carried to that consumer increases).

51. *Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216, 218 (D.C. Cir. 2014).

52. *Id.* at 225.

53. *EnerNOC, Inc. v. Elec. Power Supply Ass'n*, 135 S. Ct. 2049, 2050 (2015).

54. *Id.*

55. *New York v. FERC*, 535 U.S. 1, 6 (2002) (quoting *Gulf States Util. Co. v. Fed. Power Comm'n*, 411 U.S. 747, 758 (1973)).

56. *See id.* at 5 ("[M]ost electricity was sold by vertically integrated utilities that had constructed their own power plants, transmission lines, and local delivery systems.").

57. *Id.*

58. *See generally* *Public Util. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927) (finding that the business relationship between a Rhode Island power producer and Massachusetts power supplier was "essentially national in character").

power supplier might buy and transmit power to distant retail customers.⁵⁹ The price of energy to the retail customer in one state now depended on the wholesale transaction between producer and supplier in another state, leading the Supreme Court to conclude the new wholesale market for energy was “essentially national in character.”⁶⁰

The Court held in *Public Util. Comm’n v. Attleboro Steam & Elec. Co.* that states are prohibited from regulating the new wholesale market.⁶¹ The Court reasoned that because one state’s regulation of the wholesale market impacted retail customers and rates in other states, no state could regulate such an interstate practice without conflicting with the interests of another state, and the power to regulate should fall exclusively to the federal government under the Commerce Clause.⁶² Because only states had theretofore regulated the energy industry, the decision created what became known as the “*Attleboro* gap”: a hole in regulation that could be filled “only ‘by the exercise of the power vested in Congress.’”⁶³

By passing the Federal Power Act (FPA) in 1935, Congress intended to fill the *Attleboro* gap and transfer to the federal government regulatory power traditionally held by the state.⁶⁴ Section 206(b)(1) of the FPA granted the precursor of FERC “jurisdiction as including ‘the transmission of electric energy in interstate commerce’ and ‘the sale of electric energy at wholesale in interstate commerce.’”⁶⁵ “Furthermore, § 205 of the FPA prohibits, among other things, unreasonable rates and undue discrimination ‘with respect to any transmission or sale subject to the jurisdiction of the Commission,’ and “§ 206 gave the FPC the power to correct such unlawful practices.”⁶⁶

59. See, e.g., *id.* at 84 (explaining that one company “engaged in manufacturing electric current” while another bought that current and “engaged in supplying” it for consumption).

60. *Id.* at 90.

61. See *id.*

62. See *id.* (“The rate is therefore not subject to regulation by either of the two states in the guise of protection to their respective local interests; but, if such regulation is required it can only be attained by the exercise of the power vested in Congress.”).

63. *New York v. FERC*, 535 U.S. 1, 6 (2002) (quoting *Attleboro*, 273 U.S. at 89).

64. *Id.*

65. *Id.* at 6–7 (citing 16 U.S.C. § 824(b) (2012)).

66. *Id.* at 7.

B. Section 201 Grants to FERC Jurisdiction over the Attleboro Gap and More

The FPA reserves for states some power to regulate the energy industry, including retail sales.⁶⁷ Section 201(a) of the FPA generally limited FERC's jurisdiction in a policy declaration "to those matters which are not subject to regulation by the States."⁶⁸ Section 201(b) specifically granted authority over "the sale of electric energy at wholesale" and specifically excluded from FERC's authority "any other sale of electric energy."⁶⁹ This was interpreted as Congress's intent "to draw a bright line easily ascertained, between state and federal jurisdiction," with retail sales falling under state authority and wholesale sales under FERC's authority.⁷⁰

As FERC's authority to set wholesale rates conflicts with the state's authority to set retail rates, the power of FERC to regulate wholesale sales has generally been thought to preempt as a result of the "plenary authority" explicitly extended by Congress.⁷¹ The general limitation of FERC's authority in § 201(a) is considered "a mere policy declaration" while § 201(b) is "a clear and specific grant of jurisdiction" that confers authority "even if the particular grant seems inconsistent with the broadly expressed purpose" articulated in the policy declaration.⁷²

The Supreme Court has more recently noted that "the landscape of the electric industry has changed since the enactment of the FPA, when the electricity universe was neatly divided into spheres of retail versus wholesale sales."⁷³ In addition, the Supreme Court clarified that the "bright line" between retail and wholesale specifically refers to *sales*, not necessarily retail *markets*, because retail transmissions are under FERC's jurisdiction.⁷⁴ There is some ambiguity, however, over

67. *See id.* at 23 ("[T]he legislative history demonstrates Congress' interest in retaining state jurisdiction over retail sales.").

68. 16 U.S.C. § 824(a) (2012).

69. 16 U.S.C. § 824(b).

70. *Fed. Power Comm'n v. S. Cal. Edison Co.*, 376 U.S. 205, 215 (1964).

71. *See, e.g., Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986) ("Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A State must rather give effect to Congress's desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.")

72. *New York*, 535 U.S. at 22 (quoting *Fed. Power Comm'n*, 376 U.S. at 215).

73. *New York*, 535 U.S. at 16.

74. *See id.* at 16–17 ("There is no language in the statute limiting FERC's *transmission* jurisdiction to the wholesale market, although the statute does limit FERC's *sale* jurisdiction to

the extent to which the distinction between wholesale and retail applies (1) solely to sales, or (2) to many components of the retail market, with federal authority over retail transmissions exceptional as “a clear and specific grant of jurisdiction.”⁷⁵

C. Sections 205 and 206 Grant FERC Jurisdiction to Fix Market Failures Affecting Wholesale Rates

The 1935 FPA also conferred FERC with responsibility to ensure the wholesale market operates with “just and reasonable” practices.⁷⁶ Where FERC uncovers “unreasonable, unjust, unduly discriminatory or preferential . . . practices . . . affecting [wholesale] rates,” 206(a) requires that FERC determine practices to remedy the deficiency in the wholesale market and order “the just and reasonable . . . practice . . . to be thereafter observed.”⁷⁷ In fact, §§ 205 and 206 do not just give FERC market-correcting *authority* where it investigates and finds unreasonable or unjust practices “affecting” wholesale rates—for FERC, § 206 creates a *duty*.⁷⁸

The Court has explicitly noted that FERC’s § 206 duty expands FERC’s jurisdiction because “practices . . . affecting [wholesale] rates” is a broader concept than wholesale rates themselves.⁷⁹ FERC may not be permitted to regulate retail sales directly because of the limits of § 201(b), but FERC’s duty under § 206 compels it to consider “the relationship between jurisdictional and nonjurisdictional rate structures.”⁸⁰ Thus, when the relationship between wholesale and retail results in “unreasonable, unjust, unduly discriminatory or preferential . . . practices,” FERC “does not invade a nonjurisdictional area” when it rectifies a jointly retail-wholesale problem, so as long as the tools FERC implements do not directly regulate retail sales.⁸¹

that at wholesale.”).

75. See *id.* at 22 (“Because the FPA contains such ‘a clear and specific grant of jurisdiction’ to FERC over interstate transmissions . . . the prefatory language [of § 201(a)] does not undermine FERC’s jurisdiction.”) (quoting *Fed. Power Comm’n v. S. Cal. Edison Co.*, 376 U.S. 205, 215 (1964)).

76. 16 U.S.C. § 824d (2012); *id.* § 824e.

77. *Id.* § 824e(a).

78. *New York v. FERC*, 535 U.S. at 27 (discussing FERC’s “§ 206 obligation to regulate”).

79. See *Fed. Power Comm’n v. Conway Corp.*, 426 U.S. 271, 281–82 (1976) (“The rules, practices, or contracts ‘affecting’ the jurisdictional rate are not themselves limited to the jurisdictional context.”).

80. See *id.*

81. See *id.* at 280–81.

To identify a problem that needs correction—whether the problem exists purely within the wholesale market or affects it—the D.C. Circuit has held that FERC does not need to make “individualized findings” but can rely on “general findings of a systematic problem to support imposition of an industry-wide solution.”⁸² It may be sufficient for FERC to identify a “general” or “theoretical threat” for the agency to exercise corrective action under § 206.⁸³ The Supreme Court has implicitly hinted approval of FERC’s general market-correcting authority under §§ 205 and 206.⁸⁴

D. Courts owe Deference to Agency Decisions

The Supreme Court recently held that courts must apply *Chevron* deference to an agency’s determination of its own jurisdiction.⁸⁵ Under the *Chevron* rule:

‘When a court reviews an agency’s construction of the statute which it administers, it is confronted with two questions.’ First, applying the ordinary tools of statutory construction, the court must determine ‘whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.’ But ‘if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute.’⁸⁶

When the interrelation between two statutory provisions creates ambiguity in the agency’s authority, the Court will accept the agency’s reasonable interpretation of its own jurisdiction.⁸⁷ On the other hand,

82. *Interstate Natural Gas Ass’n of America v. FERC*, 285 F.3d 18, 37 (D.C. Cir. 2002) (citing *Transmission Access Policy Study Grp. v. FERC*, 225 F.3d 667, 683 (D.C. Cir. 2000), *aff’d* sub nom. *New York v. FERC*, 535 U.S. 1 (2002)); *see also* *South Carolina Public Service Authority v. FERC*, 762 F.3d 41, 64 (D.C. Cir. 2014) (holding a “theoretical threat” to the energy market sufficient to trigger action under § 206) (*per curiam*).

83. *South Carolina Public Service Authority*, 762 F.3d at 64.

84. *See, e.g., New York*, 535 U.S. at 14 (2002) (describing the D.C. Circuit’s conclusion that §§ 205 and 206 permit marketwide solutions to marketwide problems and going on to uphold the determination of jurisdiction); *see also* *Morgan Stanley Capital Grp., Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash.*, 554 U.S. 527, 535–36 (2008) (describing FERC’s recent “innovative” and “ambitious program of market-based reforms . . . to break down regulatory and economic barriers that hinder a free market”).

85. *City of Arlington, Tex. v. FCC*, 133 S. Ct. 1863, 1871–73 (2013).

86. *Id.* at 1868 (quoting *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)).

87. *See, e.g., City of Arlington, Tex.*, 133 S. Ct. at 1868 (“Statutory ambiguities will be resolved, within the bounds of reasonable interpretation, not by the courts but by the

when the statute is clear and unambiguous regarding the agency's jurisdiction, the agency is bound by the statute's plain meaning.⁸⁸

Furthermore, in "ratemaking decisions" under §§ 205 and 206, the Supreme Court grants FERC "great deference" because "the statutory requirement that rates be just and reasonable is obviously incapable of precise judicial definition."⁸⁹ The Court has established that by using broad language in §§ 205 and 206 Congress conferred FERC considerable discretion to specify what constitutes a "just and reasonable" rate.⁹⁰ The "abstract quality" of "reasonableness" leaves FERC a "substantial" zone of discretion.⁹¹

Agency findings of fact are also entitled to deference.⁹² When FERC issues an order, judicial review determines whether the decision was "arbitrary or capricious" or lacked "substantial evidence," but without identifying a finding as unreasonable or unwarranted "a court is not to substitute its judgment for that of the agency."⁹³

III. HOLDING

The D.C. Circuit Court of Appeals applied *Chevron* to FERC's assertion of jurisdiction. The D.C. Circuit held that the text of the FPA unambiguously forecloses FERC's assertion of authority, thus Order 745 was vacated as "*ultra vires* agency action."⁹⁴

In reaching the conclusion that FERC's Order is *ultra vires*, the court reasoned: (i) demand response is not a wholesale sale, so FERC cannot claim authority to issue Order 745 under § 201(b)(1);⁹⁵ (ii)

administering agency.").

88. *See id.* ("Congress knows to speak in plain terms when it wishes to circumscribe, and in capacious terms when it wishes to enlarge, agency discretion.").

89. *Morgan Stanley Capital Grp., Inc.*, 554 U.S. at 532.

90. *See Montana-Dakota Util. Co. v. Nw. Pub. Serv. Co.*, 341 U.S. 246, 251 (1951) ("Petitioner cannot separate what Congress has joined together. It cannot litigate in a judicial forum its general right to a reasonable rate, ignoring the qualification that it shall be made specific only by exercise of the Commission's judgment, in which there is some considerable element of discretion.").

91. *See id.*

92. *See* 16 U.S.C. § 825l (2012) ("The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive.").

93. *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

94. *See Elec. Power Supply Ass'n. v. FERC*, 753 F.3d 216, 225 (D.C. Cir. 2014) ("Ultimately, given *Order 745*'s direct regulation of the retail market, we vacate the rule in its entirety as *ultra vires* agency action.").

95. *Id.* at 221.

demand response is a retail market phenomenon, which is “clearly” outside FERC’s jurisdiction by “the specific limits of § 201;”⁹⁶ (iii) the broad grant of authority to regulate practices “affecting” the wholesale market under §§ 205 and 206 cannot outweigh “the specific limits of § 201;”⁹⁷ and (iv) Order 745’s direct purpose is to incentivize behavior by retail consumers, so it is not relevant that FERC retains authority to regulate even when a rule has “incidentally incentivized” actions FERC could not directly require.⁹⁸ The D.C. Circuit went on to argue that even if FERC had jurisdiction, its action was arbitrary and capricious.

A. FERC Lacks Jurisdiction under § 201(b)(1)

The D.C. Circuit held that FERC could not claim authority to regulate demand response resources under § 201(b)(1) because that section only grants jurisdiction over wholesale sales.⁹⁹ Section 201(b)(1) empowers FERC to regulate “the sale of electric energy at wholesale in interstate commerce” but not “any other sale of electric energy.”¹⁰⁰ The D.C. Circuit found that demand response “is not a sale at all,” and therefore cannot constitute a wholesale sale subject to FERC’s jurisdiction.¹⁰¹

B. Demand Response is a Retail Phenomenon

The D.C. Circuit’s holding relies on its finding that Order 745 regulates the retail market rather than the wholesale market.¹⁰² Although FERC insisted it is regulating “wholesale demand response” as opposed to “retail demand response,”¹⁰³ the D.C. Circuit found the distinction to be a “fiction.”¹⁰⁴ Instead, the D.C. Circuit

96. *Id.* at 222.

97. *See id.* (“The broad ‘affecting’ language of §§ 205 and 206 does not erase the specific limits of § 201.”).

98. *Id.* at n.2 (citing *Conn. Dept. of Pub. Util. Control v. FERC*, 569 F.3d 477 (D.C. Cir. 2009)).

99. *Id.* at 221.

100. 16 U.S.C. § 824(b)(1) (2012).

101. *Elec. Power Supply Ass’n v. FERC*, 753 F.3d at 221.

102. *See id.* at 222–23 (reasoning that FERC cannot overcome its “jurisdictional quandary” because by regulating demand response FERC has directly regulated the retail market, which should be excluded from FERC’s jurisdiction over “practices affecting the wholesale market”).

103. *See id.* at 220 (“The Commission draws this distinction between ‘wholesale demand response’ and ‘retail demand response’ in an attempt to narrow the logical reach of its rule.”).

104. *Id.* at 221.

concluded, “[d]emand response—simply put—is part of the retail market.”¹⁰⁵

The D.C. Circuit disagreed with FERC’s characterization of the demand response market as “wholesale” and “retail” because both have the same goal: “a reduction in consumption” by the *retail* consumer.¹⁰⁶ The D.C. Circuit considered “retail demand response” as “FERC speak” for manipulating consumer behavior using prices, and “wholesale demand response” as manipulating consumer behavior using incentive payments, which the court considered “the same in substance and effect” as a retail credit.¹⁰⁷ Incentive payments originating in the wholesale market are not “wholesale sales,” but instead are effectively credits to alter consumers’ retail behavior.¹⁰⁸

C. FERC’s Jurisdiction under §§ 205 and 206 is Limited

The D.C. Circuit held that §§ 205 and 206 grant FERC broad jurisdiction over practices that affect wholesale rates, but *not* over demand response resources.¹⁰⁹

Sections 205 and 206 of the FPA “task FERC with ensuring ‘all rules and regulations *affecting* . . . rates’ in connection with the wholesale sale of electric energy are ‘just and reasonable.’”¹¹⁰

The D.C. Circuit held that the language of §§ 205 and 206 fail to establish FERC’s jurisdiction over demand response because the language is too broad to overcome a clear prohibition on regulation of “the retail market.”¹¹¹ The D.C. Circuit determined that the FPA includes a “clearly articulated” prohibition on regulation of “the retail market” that can only be overcome by a “clear and specific grant of

105. *Id.* at 223.

106. *See id.* (“[Demand response] involves *retail* customers, their decision whether to purchase *at retail*, and the levels of *retail* electricity consumption . . . a reduction in consumption cannot be a ‘wholesale sale.’”) (emphasis added).

107. *See id.* at 222–23 (agreeing with FERC that “demand response can occur in two ways—through a response to either price change or incentive payments” but concluding “[o]rdering an ISO to compensate a consumer for reducing its demand is the same in substance and effect as issuing a credit” which is, effectively, an impermissible change to retail price).

108. *See id.* at 223 (“[A] reduction in consumption cannot be a ‘wholesale sale.’”).

109. *See id.* at 222 (“FERC can regulate practices affecting the wholesale market under §§ 205 and 206, provided the Commission is not directly regulating a matter subject to state control, such as the retail market.”).

110. *Id.* at 221 (quoting 16 U.S.C. § 824d(a) (2012)).

111. *See id.* at 221–22 (“The broad ‘affecting’ language of §§ 205 and 206 does not erase the specific limits of § 201.”).

jurisdiction” elsewhere in the statute.¹¹² The D.C. Circuit cited its “clearly articulated” prohibition on regulation of “the retail market” in § 201(a), which limits FERC’s jurisdiction “to those matters which are not subject to regulation by the States.”¹¹³ Because the retail market is subject to regulation by the States, the D.C. Circuit reasoned it couldn’t be within the jurisdiction of FERC.¹¹⁴ Sections 205 and 206, which the D.C. Circuit characterized as “broad,” fall short of the “clear and specific grant of jurisdiction” necessary to outweigh the prohibition.¹¹⁵

In short, the D.C. Circuit held that “FERC can regulate practices affecting the wholesale market under §§ 205 and 206, provided the Commission is not directly regulating a matter subject to state control, such as the retail market.”¹¹⁶ The D.C. Circuit found regulation of demand response resources to constitute direct regulation of the retail market, and thus §§ 205 and 206 cannot empower FERC to regulate demand response resources.¹¹⁷

D. FERC Regulated the Retail Market Directly

The D.C. Circuit’s holding also relied on its finding that Order 745 *directly* impacts the retail market.¹¹⁸ The D.C. Circuit noted that FERC is permitted to regulate the retail market indirectly. In other words, FERC can incentivize behavior in the retail market as “a logical byproduct” of a permissible rule, but the D.C. Circuit found that by incentivizing demand response “FERC has *directly* incentivized action it cannot directly require.”¹¹⁹

E. FERC’s Regulation of Demand Response is Arbitrary and Capricious

The D.C. Circuit held that even if FERC had the statutory authority to execute Order 745, the order would fail as arbitrary and

112. *Id.* (quoting *New York v. FERC*, 535 U.S. 1, 22 (2002)).

113. *Id.* at 221.

114. *Id.* at 221–22 (citing *Niagara Mohawk Power Corp. v. FERC*, 452 F.3d 822, 824 (D.C. Cir. 2006)).

115. *Id.* at 221 (“Without boundaries, §§ 205 and 206 could ostensibly authorize FERC to regulate any number of areas, including the steel, fuel, and labor markets.”).

116. *Id.* at 222.

117. *Id.*

118. *See id.* at n.2 (differentiating between cases in which FERC has authority to regulate, but its rule has an incidental impact on retail market, and this case, where the D.C. Circuit finds FERC’s rule “reaches directly into the retail market”).

119. *Id.*

capricious.¹²⁰ The court held that FERC failed to engage the counterarguments raised against the order,¹²¹ including those made by fellow FERC Commissioner Moeller's.¹²² According to the D.C. Circuit, FERC further failed to properly review Moeller's concerns that by overcompensating demand response resources through payments and retained costs of generation, Order 745 would unfairly benefit retail consumers and reduce savings made by the generators.¹²³ The court also held that FERC was unable to adequately explain¹²⁴ its decision regarding the compensation levels.¹²⁵

IV. ARGUMENTS

A. Sections 205 and 206 Grant FERC Jurisdiction over Wholesale Demand Response

FERC argues¹²⁶ that the FPA grants sufficient authority under §§ 205 and 206 to issue Order 745 as a regulation of practices affecting the wholesale rates.¹²⁷ FERC's argument focuses on a plain-text reading of § 206, which authorizes FERC to fix by order a just and reasonable rule, regulation, or practice affecting wholesale rates.¹²⁸ FERC argues that demand response is an efficient method through which it can satisfy its duty to ensure just and reasonable wholesale rates by balancing energy market supply and demand.¹²⁹ FERC makes a point to argue that without this authority, demand response could not operate in the wholesale market due to the inability of the States to regulate interstate transmission or wholesale sales of electricity.¹³⁰ Emphasizing the inelasticity of demand for electricity and its statutory duty to ensure just and reasonable rates, FERC views wholesale

120. *Id.* at 224.

121. *Id.* (citing *NorAm Gas Transmission Co. v. FERC*, 148 F.3d 1158, 1165 (D.C. Cir. 1998)).

122. *Id.* at 225.

123. *Id.*

124. *Id.*

125. *Id.*

126. Note that in this section, unless otherwise noted, both petitioners' arguments are generally attributed to FERC alone for sake of readability since FERC and EnerNOC make mostly similar arguments.

127. Brief for the Petitioner, *supra* note 13, at 24.

128. 16 U.S.C. §824e(a) (2012).

129. Brief for the Petitioner, *supra* note 26, at 22–23.

130. *Id.* at 30.

demand response as the efficient tool with which it seeks to fulfill its statutory duty.¹³¹

B. Order 745 is an Attempt to Regulate the Retail Market

The Electric Power Supply Association (EPSA) counters FERC's main statutory argument by stating that the FPA, in fact, proscribes FERC from regulating demand response resources in the wholesale market, which it calls a "transparent attempt to dictate the effective rate for retail sales."¹³² EPSA points to the limits imposed § 201(a)¹³³ and claims demand response is subject to exclusive regulation by the states because the aim of demand response is reduction of consumption by *retail* customers.¹³⁴ EPSA notes that, while demand response offers benefits, retail demand response already provides incentives to retail consumers under state regulation.¹³⁵

FERC counters EPSA's state retail argument by focusing on the construction of the text and the relative strength of §§ 201(a) and 206 in setting forth FERC's jurisdiction.¹³⁶ According to FERC, § 206 grants specific jurisdiction over rules, regulations, and practices affecting wholesale rates and § 201(a) acts merely as a general declaration that jurisdiction is subject to regulation by the States if not granted in the Act.¹³⁷ FERC notes that the Court has held the language of § 201(a) to be "a mere policy declaration that cannot nullify a clear and specific grant of jurisdiction."¹³⁸ FERC again references the *Attleboro* gap, arguing that § 206 must be such a specific grant so as to allow regulation of the otherwise unregulated space of wholesale demand response, especially when read in conjunction with Congress's intent to remove barriers to demand response participation via the Energy Policy Act of 2005 § 1252(f).¹³⁹

In response, EPSA notes that § 201(b) specifically prohibits FERC from regulating retail sales, even if § 201(a) is considered to be

131. *Id.* at 19.

132. Brief for the Respondents at 25, *FERC v. Elec. Power Supply Ass'n*, Nos. 14-840, 14-841 (U.S. Aug. 31, 2015) [hereinafter Brief for the Respondents].

133. 16 U.S.C. § 824(a) (2012).

134. Brief for the Respondents, *supra* note 132, at 28.

135. *Id.* at 27.

136. Brief for the Petitioner, *supra* note 26, at 36.

137. *Id.*

138. *Id.* (quoting *New York v. FERC*, 535 U.S. 1, 6 (2002)).

139. Energy Policy Act of 2005 ("EPAct") §1252(f), Pub. L. No. 190-58, 119 Stat. 966 (16 U.S.C. § 2642).

general.¹⁴⁰ EPSA states that in doing so, FERC has made “a purposeful effort to change the timing and terms of a retail sale,” so FERC’s action directly involves a retail *sale*.¹⁴¹ EPSA also points out that the power to regulate retail sales necessarily includes the power to prohibit them from occurring, making connection to the FERC-characterized “non-sale” result of demand response.¹⁴² On behalf of Petitioners, EnerNOC responds by arguing that wholesale demand response does not involve the sale of electricity.¹⁴³ Instead, EnerNOC argues, wholesale demand response is properly viewed as an investment by demand response servicers to *indirectly* affect the consumption levels of electricity.¹⁴⁴

C. *The Court owes Chevron Deference to FERC*

Arguing in the alternative, FERC states that Order 745 should at least be subject to *Chevron* deference.¹⁴⁵ FERC argues that because the FPA limits its authority through a mere policy declaration under § 201(a) and focuses narrowly on restricting regulation of sales in § 201(b), the Act fails to establish a clear statutory proscription of the authority FERC seeks to exercise.¹⁴⁶ Thus, without such an unambiguous statutory prohibition, FERC argues that it is entitled to discuss whether it acted upon a permissible construction of the FPA under *Chevron*.¹⁴⁷ EPSA, on the other hand, argues that the FPA unambiguously limits FERC’s jurisdiction over practices “affecting wholesale rates” to matters that are not already subject to regulation by the States.¹⁴⁸ Additionally, EPSA also cites the Energy Policy Act of 2005, arguing that it reserved to states the jurisdiction of directly regulating demand response while merely tasking the federal government with removing barriers of participation.¹⁴⁹

140. Brief for the Respondents, *supra* note 132, at 36 (citing Brief for the Petitioner, *supra* note 26, at 54).

141. *Id.*

142. *Id.* at 38 (citing *Champion v. Ames*, 188 U.S. 321 (1903)).

143. Brief of Private Petitioners, *supra* note 26, at 31–32.

144. Brief for the Petitioner, *supra* note 26, at 44–45.

145. *Id.* at 44.

146. *Id.* at 44–45.

147. *Id.* at 44.

148. Brief for the Respondents, *supra* note 132, at 43 (citing 16 U.S.C. § 824(a) (2012)).

149. *Id.* at 44.

D. Order 745 is Arbitrary and Capricious

Lastly, EPSA argues that if the Court were to apply *Chevron*, Order 745 is arbitrary and capricious due to FERC's failure to use proper pricing to pursue its goal of balancing supply and demand.¹⁵⁰ EPSA argues that FERC failed to properly consider the claims of Commissioner Moeller, who argued that setting the price paid for demand response at LMP-level overcompensates demand response resources and creates an inappropriate incentive for demand response participants who would derive more benefit from such payments than energy usage. This incentive would encourage a greater number of participants than would occur under market conditions absent that incentive, thereby creating a new mismatch between supply and demand.¹⁵¹ Further, EPSA notes that Moeller's proposal—to reduce LMP by the cost of power generation (LMP minus G)—would lead to more efficient participation and an effective rate equal to the wholesale rate, a calculation realized but not applied by FERC to Order 745.¹⁵² In sum, EPSA argues that FERC's failure to properly address Moeller's concerns or reasonably explain its implementation of LMP-level pricing makes Order 745 arbitrary and capricious.¹⁵³

In response, FERC argues that it has “examine[d] the relevant data and articulate[d] a satisfactory explanation for its action,” including the use of the LMP price.¹⁵⁴ FERC argues that given its § 206 authority to regulate practices affecting wholesale rates and its § 205 duty to ensure that such rates are just and reasonable, discharging such duty demands deference to FERC judgment, regardless of a dissenting opinion.¹⁵⁵ In addition, FERC adopted the “net-benefits” test, which restricted LMP payments to scenarios in which such payments would reduce the total price paid by consumers.¹⁵⁶ This test allegedly resolves the problem raised by the dissenting member. Therefore, FERC's use of LMP is reasonable, even if deference is not afforded to its expertise.¹⁵⁷ FERC believes the “net-benefits” test can

150. *Id.* at 49–50.

151. *Id.* at 54.

152. *Id.* at 55–56 (citing *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009)).

153. *Id.* at 58–59.

154. Brief for the Petitioner, *supra* note 13, at 46–47 (quoting *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

155. *Id.* at 47 (citing *Morgan Stanley Capital Grp. Inc. v. Public Util. Dist. No. 1 of Snohomish Cnty., Wash.*, 554 U.S. 527, 532 (2008)).

156. *Id.* at 50.

157. *Id.* at 52 (citing *North Baja Pipeline, LLC v. FERC*, 483 F.3d 819, 820 (D.C. Cir.

overcome economic inefficiencies and is more practicable than LMP minus G.¹⁵⁸ Thus, the process behind Order 745's issuance should suffice to surmount the arbitrary and capricious threshold of *Chevron*.

V. ANALYSIS

The Supreme Court once again finds itself defining the bounds of FERC's jurisdiction over the energy industry. *FERC v. EPSA* can be divided into two separate conflicts.

First, the Court will have to resolve the conflicting interpretations of FERC's jurisdiction under the FPA. The issue could be cast as one of federalism. Put differently: under the FPA, where does federal authority end and state authority begin? On the other hand, that question may depend on whether § 201(a) limits §§ 205 and 206 at all. If § 201(a) is merely a subordinate prefatory clause, then the jurisdictional question is only whether §§ 205 and 206 permit regulation of the rate paid by RTOs to demand response resources.

Second, the Court may have to resolve the conflicting characterizations of Order 745 and determine whether the action lies within FERC's jurisdiction. The issue could be cast as one of deference to expert agencies. Put differently: when is it appropriate for unelected judges to reject an expert agency's characterization of an industry practice? The D.C. Circuit correctly applied *Chevron* framework to determine the threshold question of the extent of FERC's jurisdiction. It also, however, overruled FERC's finding that demand response can be characterized, at least in part, as wholesale market activity. In doing so, the D.C. Circuit withheld the deference typically afforded to agencies' findings without considering whether it is appropriate for a court to substitute its determinations for the agency's.¹⁵⁹

It is likely the Supreme Court will overturn the D.C. Circuit. In resolving the first question of how to interpret FERC's statutory jurisdiction, the Court is likely to apply the *Chevron* framework to determine (1) whether the statute sets a clear and unambiguous limit on FERC's jurisdiction and, if not, (2) whether FERC's interpretation of its authority is permissible.

2007)).

158. *Id.* at 55–56.

159. *See* Motor Vehicle Mfrs. Ass'n of the U. S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (noting “a court is not to substitute its judgment for that of the agency”).

In determining whether FERC was acting within its authority, the Court must also resolve the second controversy. It will have to determine whether FERC's order is a direct regulation of “*wholesale demand response*,” or whether that concept is a “fiction” to disguise FERC's regulation of the retail market or retail sales, as the D.C. Circuit found.¹⁶⁰

A. *The Bounds of Federal Regulatory Authority*

The jurisdictional question in this case boils down to determining the bounds of FERC's authority under §§ 205 and 206. The breadth of FERC's jurisdiction depends on the extent to which federal authority under §§ 205 and 206 is limited by the reservation of power for the states in § 201(a) and over “other sales” in § 201(b). Petitioners in this case argue §§ 205 and 206 are clear grants of authority that justify FERC's order,¹⁶¹ while the respondents argue the conflicting limits of § 201(a) and (b) prevent direct regulation of retail market and retail sales respectively.¹⁶²

The conflict between the sections of the statute is a question of statutory interpretation. The Court will therefore apply the *Chevron* framework to review FERC's order.

At the first step of the *Chevron* framework, the Court will consider whether the statute unambiguously forecloses FERC's interpretation that it has authority under §§ 205 and 206. The Supreme Court will probably agree with the D.C. Circuit that retail sales are unambiguously outside of FERC's jurisdiction because § 201(b) specifically limits FERC's jurisdiction to “the sale of electricity at wholesale,” but not “to any other sale of electric energy.” If the Court considers wholesale demand response to be an “other sale of electricity,” then the Court may end its analysis, but we predict this will not be the case.¹⁶³

The Court will likely hold as ambiguous, however, whether Congress intended the entire retail *market* to lie outside of FERC's jurisdiction. The D.C. Circuit did not hold FERC's action was *ultra vires* as a retail *sale*, only that FERC's action regulated behavior in

160. Elec. Power Supply Ass'n v. FERC, 753 F.3d 216, 221 (D.C. Cir. 2014).

161. Brief for the Petitioner, *supra* note 26, at 36.

162. Brief for the Respondents, *supra* note 132, at 24.

163. See *infra* at Part VI, Section B (predicting the Court will defer to FERC's expertise in determining whether wholesale demand response is actually a retail phenomenon).

the retail *market*.¹⁶⁴ The Supreme Court, however, has already recognized FERC has jurisdiction over interstate transmission in the retail market.¹⁶⁵ The Court may reiterate, as FERC argues, that a specific grant of jurisdiction supersedes the general and prefatory language of § 201(a).¹⁶⁶ While §§ 205 and 206 may grant broad authority, the grant is clear and specifically enables FERC to consider and act upon problems outside the jurisdiction defined in § 201.¹⁶⁷ Moreover, nowhere does the statute's text make explicit mention of the retail market. Section 201 does, as the Court held with respect to transmission, specifically grant FERC authority to regulate some elements of retail markets.¹⁶⁸ This is not the stuff of an unambiguous statutory text.

Because the Supreme Court is likely to determine that the scope of jurisdiction over the retail *market* is ambiguous, the Court will consider whether FERC's interpretation that it has such authority under §§ 205 and 206 is reasonable. FERC's interpretation is unreasonable if the agency acted in an "arbitrary and capricious" manner, as the D.C. Circuit held.¹⁶⁹ If the Court finds FERC's action to have been based on a permissible construction of the FPA, then it may defer to FERC judgment regarding the issuance of Order 745.

As the Court has previously ruled, the "arbitrary and capricious" standard is narrow and in its application, courts shall not substitute its own judgment for that of the agency.¹⁷⁰ Instead, the order must be sustained if the agency "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action[,] including a rational connection between the facts found and the choice made."¹⁷¹ In addition to the required agency deference of the "arbitrary and capricious" standard, the Congressional intent behind § 205 in assigning FERC the duty of both defining and ensuring "just and

164. Elec. Power Supply Ass'n, 753 F.3d at 221–22.

165. *New York v. FERC*, 535 U.S. 1 (2002).

166. *Id.*; see also Brief for the Petitioner, *supra* note 13, at 36.

167. See *Fed. Power Comm'n v. Conway Corp.*, 426 U.S. 271, 281 (1976) ("The rules, practices, or contracts 'affecting' the jurisdictional rate are not themselves limited to the jurisdictional context.").

168. See *generally* *New York v. FERC*, 535 U.S. 1 (2002).

169. *Id.* at 224.

170. *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

171. *Id.* (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

reasonable”¹⁷² rates naturally leads the Court to grant greater deference in ratemaking decisions.¹⁷³

The Supreme Court, therefore, is likely to overturn the D.C. Circuit and defer to FERC's interpretation of its own jurisdiction, based in large part on its past decisions in *New York v. FERC* and *FPC v. Conaway*.¹⁷⁴

B. Deference to FERC on the Question of whether Demand Response Constitutes Retail or Wholesale Activity

In addition to the question of FERC's jurisdiction, the Court must also assess whether the D.C. Circuit was right to summarily reject FERC's characterization of “wholesale demand response.” It might re-characterize demand response as a wholly retail market phenomenon, as the D.C. Circuit did,¹⁷⁵ or even as a form of retail sale, as EPSA argues.¹⁷⁶

The parties debate whether demand response exists in the wholesale market or whether it is a metaphysically creative re-characterization of a retail practice. FERC claims demand response exists at the intersection of wholesale and retail markets, analogous to how power distributors operate within each market as intermediaries between the two. FERC insists that Order 745 is tailored to regulate wholesale operations because it directs a wholesale rate, not a retail rate. On the other hand, EPSA argues that “wholesale rates” are not rates at all, but effectively a credit to directly alter the price of electricity at retail.¹⁷⁷ FERC admits that the aim of all demand response is to incentivize retail behavior, because it identifies a problem with the relationship between the wholesale and retail markets, but says its solution to the problem takes place solely within the wholesale market, even if the order indirectly impacts retail rates and behavior.

172. 16 U.S.C. § 824d(a) (2012).

173. *Morgan Stanley Capital Grp. Inc. v. Public Util. Dist. No. 1 of Snohomish Cnty.*, Wash., 554 U.S. 527, 532 (2008).

174. *New York v. FERC*, 535 U.S. 1 (2002) (holding that no statutory language limits FERC's authority over retail transmissions and reasoning that the spheres of retail and wholesale are no longer neatly divided); *FPC v. Conaway*, 426 U.S. 273 (1976) (holding that FERC's predecessor had authority, and even duty, to consider the retail market when exercising its regulatory authority within the wholesale market).

175. *Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216, 223 (D.C. Cir. 2014).

176. Brief for the Respondents, *supra* note 132, at 25.

177. *Id.* at 46.

The Court may or may not agree with FERC’s characterization of demand response as either “wholesale demand response” or “retail demand response,” but it is likely to use a more deferential standard than did the D.C. Circuit.

The D.C. Circuit might even be rightly viewed as exhibiting inappropriate “judicial activism” when it found that “[d]emand response—simply put—is part of the retail market.” On its face, the D.C. Circuit majority treated the case as if it were a question of statutory interpretation subject to *Chevron* deference, and held the action *ultra vires* based on its statutory interpretation that FERC unambiguously lacks authority to directly regulate retail markets. In fact, however, the D.C. Circuit’s holding rests on its rejection of FERC’s finding that demand response resources operate, at least in part, within wholesale markets. The D.C. Circuit reasoned that “FERC *can* regulate practices affecting the wholesale market under §§ 205 and 206, provided the Commission is not directly regulating a matter subject to state control, such as the retail market.”¹⁷⁸ The D.C. Circuit’s interpretation of the statute would have led to the opposite conclusion—that FERC’s order was a legitimate exercise of agency authority—had the court deferred to FERC’s finding that demand response resources operate in wholesale markets, at least in part.

When the Supreme Court reviews this case, it will probably not disregard FERC’s finding outright, but review the finding with proper deference under the “substantial evidence” or “arbitrary and capricious” standards. Findings by agencies are subject to review, but “a court is not to substitute its judgment for that of the agency.”¹⁷⁹

CONCLUSION

The Supreme Court should overturn the D.C. Circuit and hold that FERC acted within its authority when it regulated the wholesale rate paid to demand response resources. In doing so, the Court should defer to FERC’s interpretation of its jurisdiction under §§ 205 and 206. Upon identification of an “unjust or unreasonable” rate or practice “affecting” the wholesale market, FERC may respond by fixing a rate or practice within its traditional jurisdiction or connected to the wholesale market, so long as it does not regulate retail sales.

178. *Elec. Power Supply Ass’n*, 753 F.3d at 222 (emphasis added).

179. *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

FERC will be empowered to take broader actions to correct market failures that originate in the retail market or outside of its traditional jurisdiction. In addition, the Court will have another opportunity to examine deference to agencies and reaffirm the standards of review for agency orders and findings.